

Before the
Federal Communications Commission
Washington, D.C. 20554

In the Matter of)
Jurisdictional Separations and Referral to the) CC Docket No. 80-286
Federal-State Joint Board)

REPORT AND ORDER

Adopted: May 11, 2001

Released: May 22, 2001

By the Commission:

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I. INTRODUCTION

1. Today we take a significant step towards reforming outdated regulatory mechanisms that are out of step with today's rapidly-evolving telecommunications marketplace. Specifically, we take action to freeze, on an interim basis, the Part 36 jurisdictional separations rules, in order to stabilize and simplify the separations process while we continue to work on more comprehensive separations reform. The current Part 36 separations regime, which has been largely unmodified for the past several decades, was developed when local telephone service was provided largely through circuit-switched networks operated by companies with monopoly power in the local market, with clear delineation between interstate and intrastate services. Since the enactment of the Telecommunications Act of 1996, however, and the growing presence of new, high-bandwidth technologies and services in the local market, including the Internet, the telecommunications landscape has changed significantly, and lines between interstate and intrastate services are becoming increasingly blurred. In addition, with the emergence of some competitive local exchange providers, we need to reexamine regulatory structures that apply only to incumbent local exchange carriers. We take the first step in this Report and Order towards the eventual reform or elimination of one such regulatory structure.

2. In this Report and Order, we adopt the recommendation of the Federal-State Joint Board established in CC Docket No. 80-286 (Joint Board)¹ to impose an interim freeze of the Part 36 category relationships and jurisdictional cost allocation factors.² Specifically, pending comprehensive reform of the Part 36 separations rules, we adopt a freeze of all Part 36 category relationships and allocation factors for price cap carriers, and a freeze of all allocation factors for rate-of-return carriers.³ The interim freeze will be in effect for five years or until the Commission has completed comprehensive separations reform, whichever comes first. We further conclude that several issues, including the separations treatment of Internet traffic, should be addressed in the context of comprehensive separations reform.⁴ We believe that these measures will bring

¹ Section 410 of the Communications Act of 1934, as amended (the Act), requires that the Commission refer any proceeding regarding the jurisdictional separation of common carrier property and expenses between interstate and intrastate operations to a Federal-State Joint Board. 47 U.S.C. §410(c). The Joint Board for jurisdictional separations was established in CC Docket No. 80-286. *See Amendment of Part 67 of the Commission's Rules*, Notice of Proposed Rulemaking and Order Establishing a Joint Board, CC Docket No. 80-286, 78 FCC 2d 837 (1980).

² *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Recommended Decision, 15 FCC Rcd 13160, FCC 00J-2 (released July 21, 2000) (*Recommended Decision*).

³ The specific Part 36 jurisdictional allocation factors and category relationships that are subject to the freeze are outlined in Appendix B of this Order.

⁴ *See infra*, paras. 34-42.

simplification and regulatory certainty to the separations process in a time of rapid market and technology changes until reform is completed.

II. BACKGROUND

3. Jurisdictional separations is the process by which incumbent local exchange carriers (ILECs) apportion regulated costs between the intrastate and interstate jurisdictions.⁵ Historically, one of the primary purposes of the separations process has been to prevent ILECs from recovering the same costs in both the interstate and intrastate jurisdictions.⁶ Jurisdictional separations is the third step in a four-step regulatory process that begins with an ILEC's accounting system and ends with the establishment of rates for the ILEC's interstate and intrastate regulated services. First, carriers record their costs, including investments and expenses, into various accounts in accordance with the Uniform System of Accounts (USOA) prescribed by Part 32 of the Commission's rules.⁷ Second, carriers assign the costs in these accounts to regulated and nonregulated activities in accordance with Part 64 of the Commission's rules to ensure that the costs of non-regulated activities will not be recovered in regulated interstate service rates.⁸ Third, carriers separate the

⁵ For purposes of section 251 of the Act, a local exchange carrier (LEC) is regarded as an "incumbent local exchange carrier" (ILEC) for a specific area if, on the date of enactment of the Act, the carrier provided telephone exchange service in that area and was deemed to be a member of the National Exchange Carrier Association, Inc. (NECA), or if the carrier "became a successor or assign" of such a member on or after that date. 47 U.S.C. § 251(h)(1). Pursuant to section 69.601(b) of the Commission's rules, "[a]ll telephone companies that participate in the distribution of Carrier Common Line revenue requirement, pay long term support to association Common Line tariff participants, or receive payments from the transitional support fund administered by [NECA] shall be deemed to be members." 47 C.F.R. § 69.601(b). For purposes of this Report and Order, the term "carriers" refers to ILECs. We note that, unlike the ILECs, competitive local exchange carriers (CLECs) are not subject to the requirements of Parts 36. See 47 C.F.R. §§ 36.

⁶ As the Supreme Court has recognized, procedures for the separation of intrastate and interstate property and expenses are necessary for the appropriate recognition of authority between the interstate and intrastate jurisdictions. *Smith v. Illinois Bell Tel. Co.*, 282 U.S. 133, 148 (1930) (*Smith v. Illinois*). The Supreme Court added that "[w]hile the difficulty in making an exact apportionment of the property is apparent, and extreme nicety is not required, only reasonable measures being essential, it is quite another matter to ignore altogether the actual uses to which the property is put." *Id.* at 150-151.

⁷ 47 C.F.R. Part 32.

⁸ The Part 64 cost allocation rules are codified at 47 C.F.R. §§ 64.901-904. Non-regulated activities generally consist of activities that have never been subject to regulation under Title II; activities formerly subject to Title II regulation that the Commission has preemptively deregulated; and activities formerly subject to Title II regulation that have been deregulated at the interstate level, but not preemptively deregulated at the intrastate level, which the Commission decides should be classified as non-regulated activities for Title II accounting purposes. See 47 C.F.R. § 32.23(a). See *Accounting Safeguards under the Telecommunications Act of 1996*, Report and Order, CC Docket No. 96-150, 11 FCC Rcd 17539, 17573 (1996), *recon. granted in part and denied in part*, Report and Order in CC Docket No. 98-81, First Order on Reconsideration in CC Docket No. 96-150, Fourth Memorandum Opinion and Order in AAD File No. 98-43, 14 FCC Rcd 11396 (1999) (granting petitions for reconsideration in part and adopting changes to section 274(f) reporting requirements), *recon. denied*, Second Order on Reconsideration, FCC 00-9 (rel. January 18, 2000) (rejecting petitions for reconsideration on the (continued...))

regulated costs between the intrastate and interstate jurisdictions in accordance with the Commission's Part 36 separations rules.⁹ Finally, carriers apportion the interstate regulated costs among the interexchange services and rate elements that form the cost basis for their interstate access tariffs.¹⁰ Carriers perform this apportionment in accordance with Part 69 of the Commission's rules.¹¹ The intrastate costs that result from application of the Part 36 rules form the foundation for determining carriers' intrastate rate base, expenses, and taxes.

4. The first step in the separations process requires carriers to assign regulated costs to various categories of plant and expenses. In certain instances, costs are further disaggregated among service categories.¹² In the second step, the costs in each category are apportioned between the intrastate and interstate jurisdictions. These jurisdictional apportionments of categorized costs are based upon either a relative use factor, a fixed allocator, or, when specifically allowed in the Part 36 rules, by direct assignment.¹³ For example, loop costs are allocated by a fixed allocator, which allocates 25% of the loop costs to the interstate jurisdiction and 75% of the costs to the intrastate jurisdiction.¹⁴

5. In 1997, the Commission initiated a proceeding seeking comment, among other things, on the extent to which legislative changes, technological changes, and market changes warrant comprehensive reform of the separations process.¹⁵ The Commission noted that the current network (Continued from previous page) _____ grounds that the petitions raised no new arguments). Similarly, state jurisdictions have the ability to remove the costs of state non-regulated activities so that those costs will not be recovered in regulated intrastate service rates.

⁹ 47 C.F.R. Part 36. See also *MCI Telecommunications Corp. v. FCC*, 750 F.2d 135, 137 (D.C. Cir. 1984) (*MCI v. FCC*) (stating that "[j]urisdictional separations is a procedure that determines what proportion of jointly used plant should be allocated to the interstate and intrastate jurisdictions for ratemaking purposes").

¹⁰ Part 61 of the Commission's rules prescribes the procedures for filing and updating interstate tariffs. See 47 C.F.R. Part 61.

¹¹ 47 C.F.R. Part 69.

¹² For example, central office equipment (COE) Category 1 is Operator Systems Equipment, Account 2220. The Operator Systems Equipment account is further disaggregated or classified according to the following arrangements: (i) separate toll boards; (ii) separate local manual boards; (iii) combined local manual boards; (iv) combined toll and DSA boards; (v) separate DSA and DSB boards; (vi) service observing boards; (vii) auxiliary service boards; and (viii) traffic service positions. See 47 C.F.R. § 36.123.

¹³ Because some costs are directly assigned to a jurisdictionally pure service category, *i.e.* a category used exclusively for either intrastate or interstate communications, both steps are often effectively performed simultaneously. For example, the cost of private line service that is wholly intrastate in nature is assigned directly to the intrastate jurisdiction. See 47 C.F.R. § 36.154(a).

¹⁴ See 47 C.F.R. § 36.154(c).

¹⁵ *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, Notice of Proposed Rulemaking, CC Docket No. 80-286, 12 FCC Rcd at 22126-22131, paras. 9-19 (*NPRM*). The Commission also contemplated issuing a further notice of proposed rulemaking prior to adoption of comprehensive separations reform. *Id.* at 22131-22132, para. 21.

infrastructure is vastly different from the network and services used to define the cost categories appearing in the Commission's current Part 36 rules, and that the separations process codified in the current Part 36 rules was developed during a time when common carrier regulation presumed that interstate and intrastate telecommunications service must be provided through a regulated monopoly.¹⁶

In addition, the Commission sought comment on several proposals previously submitted to the Commission.¹⁷ The Commission also invited the State Members of the Joint Board (State Members) to develop a report that would identify additional issues that should be addressed by the Commission in its comprehensive separations reform effort.

6. On December 21, 1998, the State Members filed a report setting forth additional issues that they believe should be addressed by the Joint Board in connection with its consideration of comprehensive separations reform.¹⁸ The State Report proposed an interim freeze, among other things, to reduce the impact of changes in telephone usage patterns and resulting cost shifts from year to year.¹⁹

7. On July 21, 2000, the Joint Board issued its *Recommended Decision* for an interim freeze of the Part 36 category relationships and allocation factors.²⁰ The Joint Board recommended interim action to provide simplicity and stability to the separations process while the Commission and the Joint Board continue to review comprehensive reform in light of legislative, technological, and market changes. Accordingly, the Joint Board recommended that,

¹⁶ *NPRM*, 12 FCC Rcd at 22126, para. 9.

¹⁷ For example, NYNEX proposed in its *Petition for Forbearance* that all costs be separated for each study area based on a single, frozen interstate allocation factor. See *New England Telephone and Telegraph Company and New York Telephone Company*, Petition for Forbearance from Jurisdictional Separations Rules, AAD 96-66 (filed May 2, 1996) (*NYNEX Petition for Forbearance*); *New England Telephone and Telegraph Company and New York Telephone Company*, Public Notice, AAD 96-66, 11 FCC Rcd 7139 (1996) (soliciting Comments on the NYNEX petition); *New England Telephone and Telegraph Company and New York Telephone Company*, Order, AAD 96-66, 12 FCC Rcd 2308 (1997) (denying the NYNEX petition and incorporating the issues raised by NYNEX into this proceeding). In response to the NYNEX *Petition for Forbearance*, BellSouth proposed a two-factor freeze, using separate factors for investment and expenses in each state. See *BellSouth NYNEX Petition for Forbearance* Comments at 2. SBC proposed a simplification of separations through a freeze of the allocation factors for each category, but only after jurisdictional allocations had stabilized, following an initial consolidation of several dozen plant and service categories into four cost categories. See *SBC NYNEX Petition for Forbearance* Comments at 4. SBC, however, did not believe that separations reform should be undertaken immediately; instead, SBC recommended waiting until three related proceedings, interconnection, universal service, and access charge reform, had been substantially completed. *Id.* at 2.

¹⁸ See *State Members' Report on Comprehensive Review of Separations*, CC Docket No. 80-286, filed December 21, 1998 (State Report).

¹⁹ See State Report at 15-16.

²⁰ *Recommended Decision*, 15 FCC Rcd 13160. The Commission sought public comment on the *Recommend Decision*. See *Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Public Notice, DA 00-1865 (rel. August 15, 2000); Public Notice, DA No. 00-2433 (rel. October 30, 2000).

until comprehensive reform can be achieved, the Commission should freeze Part 36 category relationships and jurisdictional allocation factors for price cap carriers and allocation factors only for rate-of-return carriers.²¹ The Joint Board further recommended that the Commission implement the freeze based on data from the twelve-month period immediately prior to the Commission's issuance of an order on the *Recommended Decision*.²²

8. The Joint Board also recommended that, if the Commission finds that Internet traffic is jurisdictionally interstate in the *Intercarrier Compensation for ISP-Bound Traffic Remand Proceeding*, the Commission should freeze the local DEM factor for the duration of the freeze at some substantial portion of the current year level based on data from the twelve months preceding the implementation of the freeze.²³ The Joint Board recommended that, based on the record established in connection with the *Recommended Decision*, the precise percentage of the current year's local DEM should be established according to how much of a reduction in local DEM is warranted in light of any effects that Internet usage has had on jurisdictional allocations or consumers. Finally, the Joint Board recommended that the Commission continue to consider, in the context of comprehensive reform, other proposals in the record, such as the NYNEX single frozen factor proposal.²⁴

III. PART 36 FREEZE

9. In this Report and Order, we adopt the Joint Board's recommendation to freeze the Part 36 category relationships and jurisdictional allocation factors for price cap carriers and the allocation factors only for rate-of-return carriers. The specific category relationships and allocation factors to be frozen are enumerated in Appendix B of this Report and Order. The frozen category relationships and allocation factors will be based on data from the carriers' calendar-year 2000 separations studies and will be effective July 1, 2001. The freeze will be in

²¹ *Recommended Decision*, 15 FCC Rcd at 13172, para. 20. "Category relationships" are the percentage relationships of each Part 36 category to the total amount recorded in its corresponding Part 32 account(s). See 47 C.F.R. Part 32, Part 36. "Jurisdictional allocation factors" are the percentage relationships that allocate costs assigned to Part 32 accounts for jointly used plant between the interstate (federal) and intrastate (state) jurisdictions. See *Id.*

²² *Recommended Decision*, 15 FCC Rcd at 13174, para. 25.

²³ *Recommended Decision*, 15 FCC Rcd at 13175-77, paras. 28-30. See *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, Declaratory Ruling in CC Docket No. 96-98 and Notice of Proposed Rulemaking in CC Docket No. 99-68, FCC 99-38, 14 FCC Rcd 3689, 3701-3703, 3710 (1999) (*Intercarrier Compensation for ISP-Bound Traffic Ruling*); *Bell Atl. Tel. Companies v. FCC*, 206 F.3d 1 (D.C. Cir. 2000) (*Bell Atlantic v. FCC*); *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996; Intercarrier Compensation for ISP-Bound Traffic*, Public Notice, CC Docket Nos. 96-98 and 99-68, FCC 00-227 (rel. June 23, 2000) (*Intercarrier Compensation for ISP-Bound Traffic Remand Public Notice*).

²⁴ *Recommended Decision*, 15 FCC Rcd at 13175-77, paras. 28-30. In determining the nature of the interim freeze, the Joint Board noted that it had considered all of the freeze proposals on the record, both interim and long-term. See, e.g., *NYNEX Petition for Forbearance*; USTA NPRM Comments at 9-12.

effect for five years from July 1, 2001, to June 30, 2006, or until the Commission has completed comprehensive reform of the Part 36 separations rules, whichever comes first. With limited exceptions, no adjustments to the frozen category relationships and allocation factors will be allowed during the freeze. We do not adopt the Joint Board's recommendation to reduce local dial equipment minutes (DEM) at the outset of the freeze to compensate for the impact of the Internet on local calling patterns, because we do not believe that the record allows us to quantify with any degree of accuracy the impact of the Internet on a nationwide basis. Concurrent with the implementation of the freeze, we will continue to work with the Joint Board to address several issues as detailed below, including the separations treatment of Internet traffic.

A. Establishment and Purpose of a Freeze

10. The Joint Board recommended that, for five years or until such time as comprehensive reform of separations can be implemented, the Commission should institute an interim freeze of the Part 36 category relationships and jurisdictional allocation factors.²⁵ The Joint Board stated that a freeze was necessary to provide stability and simplification for the separations process pending comprehensive reform.²⁶ The vast majority of commenters support the freeze as proposed by the Joint Board.²⁷ Only the California Public Utilities Commission and AT&T oppose the freeze altogether, on grounds that the freeze would lock in current flaws in the separations process, and also fail to properly allocate future costs as they arise.²⁸

11. In this Report and Order, we conclude that an interim freeze of Part 36 should be adopted. Under a freeze, price cap carriers will calculate 1) the relationships between categories of investment and expenses within Part 32 accounts and 2) the jurisdictional allocation factors, as of a specific point in time, and then lock or "freeze" those category relationships and allocation factors in place for a set period of time.²⁹ The carriers will use the "frozen" category relationships

²⁵ *Recommended Decision*, 15 FCC Rcd at 13160-61, paras 1-2.

²⁶ *Recommended Decision*, 15 FCC Rcd at 13166-67, para. 10.

²⁷ *See, e.g.*, *Beacon Recommended Decision Reply* at 1-3; *BellSouth Recommended Decision Comments* at 2-3; *CHR Recommended Decision Comments* at 3; *GSA Recommended Decision Comments* at 3-5; *GVNW Recommended Decision Comments* at 1-3; *JSI Recommended Decision Comments* at 2, 8-9, *Reply* at 1; *NECA, NRTA, NTCA & OPASTCO Recommended Decision Comments* at 2-3, *Reply* at 1; *Pennsylvania PUC Recommended Decision Comments* at 10; *Qwest Recommended Decision Comments* at 1-4, *Reply* at 1,4; *SBC Recommended Decision Comments* at 1, *Reply* at 1; *Sprint Recommended Decision Reply* at 1; *TANE Recommended Decision Comments* at 1; *TCA Recommended Decision Comments* at 1-2; *USTA Recommended Decision Comments* at 3-6, *Reply* at 1; *Verizon Recommended Decision Comments* at 1, *Reply* at 1,4; *Vermont PSB Recommended Decision Comments* at 1-2; *Warinner, Gesinger Recommended Decision Reply* at 1-2; *Wisconsin PSC Recommended Decision Reply* at 1-3, 8-9.

²⁸ *See, e.g.*, *AT&T Recommended Decision Comments* at 1-2, *Reply* at 1; *California PUC Recommended Decision Comments* at 4-5, *Reply* at 2-4.

²⁹ The specific point in time or period of time when category relationships and allocation factors are frozen shall be referred to as the "base year" of the freeze. *See* section III(C)(3), *infra*.

and allocation factors for their calculations of separations results and therefore will not be required to conduct separations studies for the duration of the freeze. As discussed below, rate-of-return carriers will only be required to freeze their allocation factors, but will have the option to freeze their category relationships at the outset of the freeze.³⁰

12. We agree with the Joint Board and the commenters that instituting a mandatory interim freeze of Part 36 is consistent with our goals of stabilizing and simplifying the Part 36 separations process pending comprehensive reform. First, with regard to the goal of stability, we believe that a freeze will achieve the goal of stability and provide regulatory certainty for carriers by minimizing any cost shift impacts on separations results that might occur as a result of circumstances not contemplated by the Commission's current Part 36 rules, such as growth in local competition and new technologies.³¹ Since the *NPRM* was released in 1997, there have been rapid changes in the telecommunications infrastructure, such as the growth in Internet usage and the increased usage of packet switching. We believe that these types of changes may produce cost shifts in separations results because these and other new technologies, such as digital subscriber

³⁰ See section III(C)(1), *infra*. As described more fully below, we adopt a freeze of category relationships and jurisdictional allocation factors for price cap carriers and a freeze of allocation factors only for rate-of-return carriers. "Price cap carriers" are those ILECs who are specified as subject to federal price cap regulation or have elected federal price cap regulation under Part 61 of the Commission's rules. See 47 C.F.R. §61.41. Under price cap regulation, prices cannot exceed certain prescribed limits that typically change annually based on the index reflecting changes in productivity, input costs, and other pertinent factors. See *Policy and Rules Concerning Rates for Dominant Carriers*, Report and Order and Second Further Notice of Proposed Rulemaking, CC Docket No. 87-313, 4 FCC Rcd 2873 (1989); 47 C.F.R. §§ 61.41 - 61.48. The price cap carriers include, among others, the operating companies owned by the Bell holding companies, Citizens Utilities Company, GTE Corporation, and the Sprint Corporation. "Rate-of-return carriers" are those carriers that are not subject to price cap regulation. Rate-of-return carriers either file tariffs on their own, or participate in tariffs filed by NECA. Each company participating in the tariffs administered by NECA charges the rates appearing in those tariffs, pools its revenues with other participants, and receives an amount from the pools equal to its costs (or surrogate cost through average schedules) and its *pro rata* share of the pools' earnings. Rate-of-return carriers include more than 1200 carriers nationwide operating in approximately 1400 study areas. The carriers subject to the Part 36 rules include approximately 70 price cap ILECs and more than 600 rate-of-return ILECs that perform separations to determine their actual interstate and intrastate costs. The other nearly 600 rate-of-return ILECs are referred to as "average schedule" companies and do not perform separations under the Part 36 rules. See also *Mid-Plains Telephone Company, Inc., Petition for Declaratory Ruling Regarding the Commission's Part 36 Separations Procedures, Memorandum Opinion and Order*, AAD 9-1939, 5 FCC Rcd 7050 (1990). Average schedule companies are defined by rule as telephone companies that were receiving average schedule settlements on December 1, 1982. See 47 C.F.R. §69.605(c).

³¹ Jurisdictional cost shifts in separations results generally are caused by changes in any of three areas: overall cost levels, categorization of costs (*i.e.* relative category assignments), or jurisdictional allocation factors. A carrier's increased overall cost level in a Part 32 account that has a high cost allocation to the interstate jurisdiction will cause shifts to the interstate jurisdiction for other investment and expense accounts whose jurisdictional allocations are dependent on that account. Increasing investment in specific categories (*e.g.* interexchange cable and wire facilities (C&WF)) may also contribute to jurisdictional shifts in the final results. Likewise, changes in customer calling patterns (*e.g.*, increased interstate calling) will cause shifts in the jurisdictional allocation factors, many of which are based on usage. These factors allocate a significant portion of a carrier's investment between the interstate and intrastate jurisdictions.

line (DSL) services, as well as a competitive local exchange marketplace, are not sufficiently contemplated by the current Part 36 rules.³² We believe, therefore, that the most effective action at this time will be to freeze the separations process on an interim basis, until the Commission and the Joint Board have had the opportunity to more comprehensively reform Part 36. We recognize that some commenters oppose a freeze on grounds that a freeze would not account for major changes in the telecommunications marketplace and would only serve to continue what they claim is a current misallocation of costs to the interstate jurisdiction.³³ We believe that such concerns are offset by the added regulatory certainty that carriers will enjoy, since freezing the separations process in place will avoid any sudden cost shifts in this time of rapid change. We stress that, under the principles of *Smith v. Illinois*, extreme precision is not required in the separations process, and therefore the freeze is a reasonable and legally sound method by which to stabilize the separations process pending further reform.³⁴

13. Second, with regard to simplification, we believe that a freeze of the separations process will reduce regulatory burdens on carriers during the transition from a regulated monopoly to a deregulated, competitive environment in the local telecommunications marketplace. At the present time, ILECs are required under the Part 36 rules to perform separations studies, while CLECs have no similar requirements. We believe that a freeze will further the Commission's stated goal in the *NPRM* of achieving greater competitive neutrality during the transition to a competitive marketplace by simplifying the separations process for those carriers subject to Part 36.

14. The freezing of factors and categories will reduce the Part 36 administrative burden on ILECs in several specific ways. First, those carriers will no longer have to develop jurisdictional allocation factors for interstate purposes, as frozen factors will be carried forward from year to year and used by carriers to calculate their separations results. Second, price cap carriers and rate-of-return carriers who elect to freeze their categories will not have to perform the analyses necessary to categorize annual investment changes for interstate purposes. The categories of investment, such as central office equipment (COE) and cable and wire facilities (C&WF) investment, will be assigned to categories and, where appropriate, subcategories for the

³² For example, the increased use of packet-switched technologies may call into question the continued validity of usage-based separations procedures designed for circuit-switched technologies and services. Packet-switched networks use a switching technique in which data is divided into packets for routing through the network. Packet switching enables a single transmission path, *i.e.*, a circuit, to carry packets from many different customers during the same period. In contrast, circuit-switching dedicates a single transmission path to one customer for the duration of a call. The Part 36 rules do not appropriately address the allocation methods for these newer technologies.

³³ See, *e.g.*, *AT&T Recommended Decision* Comments at 1-2, Reply at 7-12; *California PUC Recommended Decision* Comments at 4-5, Reply at 4-8.

³⁴ See section III(B), *infra*.

given year based on the frozen category relationships.³⁵

B. Legal Authority to Implement a Freeze

15. The Joint Board asserted that the Commission has legal authority to institute an interim freeze to provide stability to the separations process and to preserve the status quo pending comprehensive reform.³⁶ First, the Joint Board stated that an interim freeze of the Part 36 allocation factors and category relationships would not contravene the United States Supreme Court's ruling in *Smith v. Illinois*.³⁷ The Joint Board argued that, under an interim freeze, the costs and revenues associated with ILEC operations would still be separated between the intrastate and interstate jurisdictions, consistent with *Smith v. Illinois*, which does not require "extreme nicety" in the separations process.³⁸ Accordingly, the Joint Board concluded that a freeze whereby category relationships and/or factors are not recalculated on an annual basis using current data, but instead are frozen as of a specific year, satisfies the *Smith v. Illinois* requirement for cost allocation.³⁹ Second, the Joint Board found that there is precedent for the Commission's "freezing" of certain regulations and, in particular, freezing elements of Part 36 of the Commission's rules, such as its 1982 decision to freeze the subscriber plant (SPF) factor.⁴⁰ The Joint Board noted that the Commission previously has frozen certain regulations in order to address changes in the telephone network and its usage, and to reduce any potential, sudden cost shift impact of such changes.⁴¹

³⁵ COE includes, for example, operator systems equipment and local switching equipment. See 47 C.F.R. §§36.123-26. C&WF includes, for example, exchange line (loop) facilities. See 47 C.F.R. §§36.151-57.

³⁶ *Recommended Decision*, 15 FCC Rcd at 13167-69, paras. 12-13.

³⁷ *Smith v. Illinois*, 282 U.S. 133 (1930).

³⁸ *Smith v. Illinois*, 282 U.S. at 150-151; see Ameritech *NPRM* Comments at 11-12.

³⁹ *Recommended Decision*, 15 FCC Rcd at 13167-68, para. 12.

⁴⁰ *Recommended Decision*, 15 FCC Rcd at 13168-69, para. 13. The SPF factor is the percentage allocator that allocates non-traffic sensitive subscriber plant costs between the interstate and intrastate jurisdictions. Subscriber plant equipment includes the line connecting homes to the local switching office and the termination of that access line in the local switching office and the subscriber's premises. The Commission imposed the 1982 freeze of the SPF factor to halt the growth in allocation of exchange plant costs to the interstate jurisdiction, while the Commission continued revision of the cost allocation procedures. See *Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Decision and Order, CC Docket No. 80-286, 89 F.C.C.2d 1 (1982).

⁴¹ For example, the Commission adopted a freeze of all study area boundaries as of November 15, 1984, for universal service funding determinations. See *MTS and WATS Market Structure, Amendment of Part 67 of the Commission's Rules and Establishment of a Joint Board*, Recommendation to the Commission, CC Docket Nos. 78-72 and 80-286, 49 Fed. Reg. 48325 (Dec. 12, 1984), adopted by the Commission, Final Rule, 50 Fed. Reg. 939 (Jan. 8, 1985), 47 C.F.R. Appendix – Glossary, "Study Area." Similarly, as an interim hold-harmless measure, the Commission decided to maintain the Part 36 high-cost support mechanism for non-rural carriers during the transition to a new forward-looking high-cost support mechanism. See *Federal-State Joint Board on Universal Service, Forward-Looking Mechanism for High-Cost Support for Non-rural LECs*, Report and Order, (continued....)

16. The overwhelming majority of commenters believe that the Commission has sufficient legal authority to adopt the recommended freeze.⁴² Only the California PUC disagrees with the Joint Board on this issue.⁴³ The California PUC contends that the recommended freeze would have a far greater impact on carriers and consumers than the SPF freeze involved in *MCI v. FCC*, because the SPF allocated non-traffic sensitive costs and the recommended freeze would lock traffic-sensitive allocation factors in place.⁴⁴ The California PUC argues that the recommended freeze would therefore fail to properly allocate costs as changes occur in traffic patterns during the freeze and thereby violate cost causation principles.⁴⁵ Furthermore, the California PUC believes that the recommended freeze would result in separations results that fail to reflect shifts in investment and usage and therefore would not meet the requirement of *Smith v. Illinois*.⁴⁶

17. We agree with the Joint Board and the majority of commenters that the Commission has sufficient legal authority under the Communications Act to adopt the recommended freeze. Moreover, we believe the recommended freeze is consistent with *Smith v. Illinois* and prior Commission decisions implementing “freezes” of certain rules. We disagree with the California PUC’s contention that the recommended freeze is inconsistent with the SPF freeze. Both freezes represent interim measures used to preserve the status quo pending reform and provide for a reasonable allocation of costs between the jurisdictions consistent with *MCI v. FCC* and *Smith v. Illinois*. Indeed, as previously stated, *Smith v. Illinois* does not require absolute precision in the separations cost allocation process. Furthermore, since the freeze is not a permanent freeze, but rather a transitional measure we adopt for five years, and because separations results have not fluctuated widely in recent years,⁴⁷ there will not be such large cost misallocations that the freeze will produce results contrary to the principles of *Smith v. Illinois*. In sum, we conclude that the interim freeze is a reasonable and legally permissible approach for the Commission to take for a 5-year period in order to simplify and stabilize the separations process prior to taking up

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CC Docket Nos. 96-45, 97-160, FCC 99-306, para. 77-88 (rel. Nov. 2, 1999); *Federal-State Joint Board on Universal Service*, Recommended Decision, CC Docket No. 96-45, FCC 00J-1 (rel. June 30, 2000).

⁴² See, e.g., *BellSouth Recommended Decision* Comments at 4-5; *Qwest Recommended Decision* Comments at 10-13; *USTA Recommended Decision* Comments at 6; *Verizon Recommended Decision* Comments at 3-4.

⁴³ See *California PUC Recommended Decision* Comments at 5-6. We note that the Pennsylvania PUC contends that section 254(k) of the Act is relevant to this issue. See *Pennsylvania PUC Recommended Decision* Comments at 9. We conclude that section 254(k) does not speak to how costs should be allocated between the interstate and intrastate jurisdictions and therefore is not relevant. See *Verizon Recommended Decision* Reply at 2; *Southwestern Bell Telephone Company v. FCC*, 153 F.3d 523, 559 (8th Cir. 1998).

⁴⁴ See *California PUC Recommended Decision* Comments at 4-5. See also n.40, *supra*.

⁴⁵ See *California PUC Recommended Decision* Comments at 5-6.

⁴⁶ See *Id.* at 16.

⁴⁷ For instance, according to ARMIS 43-04 reports for the years 1996 through 2000, the percentage of net investment assigned to the interstate jurisdiction was 25.2%, 25.8%, 27.4%, 28.1%, and 27.8%, respectively.

comprehensive reform.

C. Components of the Freeze

1. Application of the Freeze to Price Cap and Rate-of-Return Carriers

18. The Joint Board recommended that a categories and factors freeze be mandatory for all price cap carriers subject to the Commission's Part 36 rules, as advocated by many commenters.⁴⁸ For rate-of return carriers, however, the Joint Board recommended that a mandatory factors-only freeze apply.⁴⁹ Although the Joint Board recognized that a factors and categories freeze would provide more certain separations results for all carriers, the Joint Board was persuaded by the record that a categories freeze may harm rate-of-return carriers.⁵⁰ The Joint Board agreed with certain parties that rate-of-return carriers, whose investment patterns may fluctuate more than those of price cap carriers from year to year, will retain maximum flexibility for recovering costs from new plant investments (upgrades) by not freezing their category relationships.⁵¹ The Joint Board concluded that a categories freeze may harm rate-of-return carriers by limiting their ability to account for changes in investment through the separations process. In this regard, the Joint Board was concerned that a mandatory categories freeze for all rate-of-return carriers would provide disincentives for these carriers to deploy new technologies due to insufficient cost recovery.

19. Furthermore, the Joint Board recognized that a categories freeze may have a negative impact on some rate-of-return carriers' current universal service high cost support levels.⁵² The Joint Board noted that COE Category 4.13 and CW&F Category 1.3 are included in the current Universal Service High Cost Loop formula that is used for the rate-of-return carriers under Part 36.⁵³ The investment levels in these two categories may increase for rate-of-return carriers as new technologies are deployed, such as facilities to provide DSL services. If the category relationships are frozen at the current year level, rate-of-return carriers may not be able to recover these costs in the future through increased loop support under the Universal Service

⁴⁸ See *Recommended Decision*, 15 FCC Rcd at 13172, para. 20; Ameritech *NPRM* Comments at 8; Bell Atlantic *NPRM* Comments at 4; BellSouth *NPRM* Comments at 10; Southwestern Bell *NPRM* Comments at 7.

⁴⁹ See *Recommended Decision*, 15 FCC Rcd at 13172, para. 20. See n.30, *supra* for definitions of "price cap" and "rate of return" carriers.

⁵⁰ *Recommended Decision*, 15 FCC Rcd at 13172-73, para. 21; See, e.g., Dobson and McCloud *NPRM* Comments at 1-4; NECA *NPRM* Comments at 3-4; RTC *NPRM* Reply Comments at 5; Western Alliance *NPRM* Comments at 12-13; NECA Feb.4 *ex parte*; USTA *NPRM* Comments at 9-12.

⁵¹ *Recommended Decision*, 15 FCC Rcd at 13172-73, para. 21; See, e.g., NECA Feb. 17 *ex parte*; USTA Feb. 11 *ex parte*.

⁵² *Recommended Decision*, 15 FCC Rcd at 13173, para. 22; See, e.g., NECA Feb. 17 *ex parte*; USTA Feb. 11 *ex parte*.

⁵³ See 47 C.F.R. Part 36, Subpart F.

High Cost Loop formula.⁵⁴ In contrast, the Joint Board found that price cap carriers, due to their sheer size, have little fluctuation in the relative category levels within their investment accounts.⁵⁵ In other words, the category relationships for price cap carriers generally remain relatively constant on an annual basis.⁵⁶

20. Of those commenters that support a freeze, many support the Joint Board's recommendation for a bifurcated freeze approach for price cap and rate-of-return carriers.⁵⁷ Several commenters, however, recommend that rate-of-return carriers be given a one-time option to freeze their category relationships at the onset of the freeze.⁵⁸

21. We agree with the Joint Board that a freeze of both category relationships and allocation factors is appropriate for price cap carriers in order to achieve maximum stability and simplification for those carriers. We conclude, furthermore, that because of their different investment and cost structures, rate-of-return carriers should only be required to freeze their jurisdictional allocation factors at this time. We understand, however, that some rate-of-return carriers may prefer the added simplification and stability from a freeze of their category relationships.⁵⁹ Based on the record before us today, we are persuaded that providing rate-of-return carriers with an option to freeze their category relationships as well could have benefits for some rate-of-return carriers. We therefore will provide all rate-of-return carriers with a one-time option to freeze their category relationships at the outset of the freeze. Those rate-of-return carriers who elect to freeze their category relationships must notify the Commission of their election on or before July 1, 2001. We believe that this approach will give each rate-of-return carrier the flexibility to decide, based on its own circumstances and investment plans, whether a freeze of its category relationships will be beneficial.

2. Frozen Categories and Allocation Factors

22. We find that, for all price cap carriers and for those rate-of-return carriers that elect to have their categories frozen, all separations categories and subcategories, as specified in

⁵⁴ See NECA Feb. 17 *ex parte*.

⁵⁵ See, e.g., *Id.*; *Recommended Decision*, 15 FCC Rcd at 13173, para. 23.

⁵⁶ For example, a review of all companies that file ARMIS data (the majority of which are price cap companies) for the years 1995-1998 shows that telephone plant under construction (TPUC) as a percent of total plant in service (TPIS) never exceeded 4.5%, whereas many rate-of-return companies, during the same time period, had TPUC that ranged from 20% to 40% of TPIS.

⁵⁷ See, e.g., CHR *Recommended Decision* Comments at 2; NECA, NRTA, NTCA, & OPASTCO *Recommended Decision* Comments at 4-5; Pennsylvania PUC *Recommended Decision* Comments at 5-7; TCA *Recommended Decision* Comments at 5; USTA *Recommended Decision* Comments at 3-6;.

⁵⁸ See, e.g., NECA, NRTA, NTCA, & OPASTCO *Recommended Decision* Comments at 4-5; USTA *Recommended Decision* Comments at 3-6, Reply at 2-4.

⁵⁹ See *Id.*

Part 36, shall be frozen at their calendar year 2000 percentage ratios. Part 36 requires some categories of costs to be further sub-divided into additional classifications, but does not refer to those further classifications as “categories” or “subcategories.” If we were to require carriers to continue subdividing costs into these classifications, carriers still would need to perform cost studies. Because a goal of the freeze is to reduce administrative burdens on carriers, we find that any Part 36 requirement to segregate costs recorded in Part 32 accounts into categories, subcategories, or further sub-classifications shall be frozen at their percentage relationship for the calendar year 2000.

23. Similarly, we find that in order to relieve all carriers of performing traffic or relative-use studies for separations purposes, all allocation factors used to assign Part 36 categories, subcategories, or further subdivisions to the state or interstate jurisdictions shall be frozen utilizing the factors calculated for the calendar year 2000. Categories or portions of categories that have been directly assigned in the past, however, will continue to be directly assigned to each jurisdiction. In other words, the frozen factors shall not have an effect on the direct assignment of costs for categories, or portions of categories, that are directly assigned. Since those portions of facilities that are utilized exclusively for services within the state or interstate jurisdiction are readily identifiable, we believe that the continuation of direct assignment of costs will not be a burden on carriers, nor will it adversely impact the stability of separations results throughout the freeze.⁶⁰

24. Appendix A of the Recommended Decision provides the Joint Board’s recommendation of the categories and factors to be frozen.⁶¹ SBC, however, noted that Appendix A of the *Recommended Decision* failed to include Telephone Operator Expense and Published Directory Listing as frozen categories of Account 6620-Services.⁶² Because these costs and relative use factors fall within the parameters of the freeze, we agree with SBC that it is appropriate to include these costs and their relative use factors in the freeze and therefore amend the list of categories and factors as specified in Appendix B of this Report and Order.

3. Base Year of the Freeze

25. The Joint Board recommended that, for all carriers, the Part 36 freeze should be based on data from the twelve-month period immediately prior to the date of the Commission’s release of a Report and Order implementing the *Recommended Decision*.⁶³ The Joint Board believes that a freeze based on carriers’ most recent data would provide the greatest measure of

⁶⁰ Examples of facilities in which a portion can be directly assigned include, Central Office Equipment- Category 2, Tandem switching equipment and Cable and Wire Facilities-Category 2, Wideband and exchange trunk. *See* 47 C.F.R. §§ 36.124 and 36.155.

⁶¹ *Recommended Decision*, Appendix A, 15 FCC Rcd at 13181-83.

⁶² *See* SBC Comments at 3-4. *See also*, 47 C.F.R. §§ 36.374-375.

⁶³ *Recommended Decision*, 15 FCC Rcd at 13174, para. 25.

stability for the separations process.⁶⁴ Specifically, for price cap carriers, the Joint Board recommended that costs should be assigned to the Part 36 categories based upon the current year percentage relationship of each Part 36 category to the total amount recorded in its associated Part 32 account. For example, Central Office-Switching, Account 2210, for separations purposes, is categorized into Category 2 (Tandem Switching) and Category 3 (Local Switching).⁶⁵ If current year Category 2 costs are twenty percent of total Account 2210 and current year Category 3 costs are eighty percent of total Account 2210 costs, then during the interim freeze, twenty percent of Account 2210 will continue to be assigned to Category 2 and eighty percent will be assigned to Category 3.⁶⁶

26. Several commenters oppose the Joint Board's recommendation for the base year of the freeze, and instead propose allowing carriers to use their most recently completed calendar-year studies.⁶⁷ Several commenters representing the interests of rate-of-return carriers recommend basing the freeze on data from an average of years 1995-1997 to mitigate the impact of increased Internet traffic.⁶⁸ The Pennsylvania PUC supports the recommended freeze basis of data from the twelve months preceding the implementation of the freeze.⁶⁹

27. We conclude that the base year of the freeze shall be calendar year 2000, and not the twelve-month period immediately preceding the release of this Report and Order. We make this minor departure from the Joint Board's recommendation because we find that any benefit realized by using the prior 12-month period in an attempt to make the freeze as current as possible is outweighed by the simplicity and efficiency achieved through requiring all carriers to base the frozen category relationships and allocation factors on their calendar year 2000 data (*i.e.*, their calendar year 2000 separations cost studies). Furthermore, we note that, due to the structure of the reporting requirements, carriers may not, at the date of release of this Report and Order, possess data for the entire 12-month period immediately preceding the release of this Report and Order. Finally, by allowing carriers to use calendar year 2000 studies, carriers also would not be required to create any new studies in order to calculate their frozen category relationships and

⁶⁴ *Recommended Decision*, 15 FCC Rcd at 13174, para. 25.

⁶⁵ See 47 C.F.R. §§ 36.124 and 36.125. The Joint Board noted that "current year" means category relationships or factors calculated based on data from the twelve months prior to the Commission's order establishing the freeze.

⁶⁶ See Appendix B for a list of the categories and factors that we are requiring to freeze.

⁶⁷ See, e.g., NECA, TCA, NRTA & OPASTCO *Recommended Decision* Comments at 4-5; SBC *Recommended Decision* Comments at 1-2; TANE *Recommended Decision* Comments at 4; USTA *Recommended Decision* Comments at 3-6.

⁶⁸ See, e.g., NECA, NTCA, NRTA, & OPASTCO *Recommended Decision* Comments at 4-5; TANE *Recommended Decision* Comments at 3; TCA *Recommended Decision* Comments at 4-5. We note that the impact of the Internet on separations results is addressed in detail below. See *infra*, paras. 34-42.

⁶⁹ Pennsylvania PUC *Recommended Decision* Comments at 5-7.

allocation factors.

4. Length of the Freeze

28. The Joint Board recommended that the Commission institute the Part 36 freeze for a five-year period, or until the Commission takes further action in this docket.⁷⁰ The Joint Board believes that a five-year freeze period is adequate as an interim measure to maintain stable separations results while the Joint Board considers long-term, comprehensive separations reform. The Joint Board recommended that the freeze automatically expire at the end of five years, unless extended by the Commission upon the recommendation of the Joint Board.⁷¹ Several commenters support the recommended five-year freeze period.⁷² Other commenters are concerned that five years is too long and may discourage efforts toward comprehensive reform, resulting in the freeze becoming a *de facto* rule.⁷³

29. We agree with the Joint Board that five years is a reasonable length of time for the interim freeze. The five-year interim freeze period will maintain stability in jurisdictional separations, while allowing the Commission and the Joint Board sufficient time to assess and consider further separations reform. In the event that the Commission and the Joint Board are able to complete comprehensive separations reform within five years, then the freeze should be discontinued and the reformed structures implemented. We believe, furthermore, that five years is not such an unduly long period of time, and efforts towards further reform will not be discouraged or lose momentum over a five-year span. We also conclude that, prior to the expiration of the five-year period, the Commission shall, in consultation with the Joint Board, determine whether the freeze period shall be extended. The determination of whether the freeze should be extended at the end of the five-year period shall be based upon whether, and to what extent, comprehensive reform of separations has been undertaken by that time.

5. Effective Date and Continuing Review of the Freeze

30. The *Recommended Decision* was silent on the issue of the appropriate effective date for the recommended freeze. All commenters who addressed the issue recommended an effective date of January 1, 2001.⁷⁴ In the interest of implementing the freeze efficiently and swiftly, we adopt July 1, 2001, as the effective date of the freeze. We do not believe that January 1, 2001 would be an appropriate effective date of the freeze, because in the interest of simplicity and efficiency, we do not wish the freeze to have any potential retroactive effects.

⁷⁰ *Recommended Decision*, 15 FCC Rcd at 13175, para. 26.

⁷¹ *Recommended Decision*, 15 FCC at 13175, para. 26.

⁷² See, e.g., *SBC Recommended Decision Reply* at 2; *USTA Recommended Decision Comments* at 7-8.

⁷³ See, e.g., *AT&T Recommended Decision Comments* at 2; *California PUC Recommended Decision Comments* at 11; *GSA Recommended Decision Reply* at 3-6; *Pennsylvania Recommended Decision Comments* at 5-7;

⁷⁴ See, e.g., *USTA Recommended Decision Reply* at 2-4; *TANE Recommended Decision Comments* at 4.

31. The Joint Board also recommended that the Commission seek comment on the impact of the freeze after it has been in effect for two years.⁷⁵ The Joint Board also recommended that the Commission continue its comprehensive review of the separations process during the freeze in order to provide a clear pathway for comprehensive reform of separations.⁷⁶ Specifically, the Joint Board recommended that several issues be addressed by the Joint Board and the Commission in the near future as a result of the emergence of new technologies and local exchange service competition. These issues included the appropriate separations treatment of: 1) unbundled network elements (UNEs); 2) digital subscriber line (DSL) services; 3) private lines; and 4) Internet traffic.⁷⁷ Accordingly, the Joint Board recommended that the Commission commit to addressing these issues and to developing a pathway to comprehensive reform in the near term.

32. Several commenters contend that any review of the impact of the freeze during the freeze period would drain resources that should be devoted to the effort to reform the separations process, given that a freeze by its very nature would eliminate the collection of certain data and studies.⁷⁸ In contrast, the Pennsylvania PUC recommends that the Commission seek comment on the impact at the end of the first year.⁷⁹ With regard to the four issues specified above, several commenters recommend that the Joint Board and the Commission address these issues during the freeze.⁸⁰ Other commenters see these issues as unnecessary distractions from devoting time and resources during the freeze to comprehensive separations reform.⁸¹

33. We agree with the Joint Board that it would be beneficial to seek comment on the impact of the freeze prior to the expiration of the freeze. We agree with the Joint Board that two years would generally be an appropriate time to seek comment on the impact of the freeze, but believe that it is premature for us to specify at what exact point in time such review shall occur. We also agree with the Joint Board that the comprehensive review of the separations process must continue during the freeze, and we thus commit to working with the Joint Board on a continuing basis during the freeze. As part of that continuing effort towards comprehensive reform, we commit to working with the Joint Board to begin to address the four specified issues during the freeze.

⁷⁵ *Recommended Decision*, 15 FCC at 13175, para. 27.

⁷⁶ *Recommended Decision*, 15 FCC at 13175, para. 27.

⁷⁷ *Recommended Decision*, 15 FCC at 13175, para. 27.

⁷⁸ See, e.g., *BellSouth Recommended Decision Comments* at 5; *Qwest Recommended Decision Comments* at 4-6; *USTA Recommended Decision Comments* at 7-8.

⁷⁹ See, e.g., *Pennsylvania PUC Recommended Decision Comments* at 5-7.

⁸⁰ See, e.g., *GSA Recommended Decision Comments* at 6, *Reply* at 8; *NECA, NCTA, NRTA & OPASTCO Recommended Decision Reply* at 2-5..

⁸¹ See, e.g., *Qwest Recommended Decision Comments* at 4-6.

6. Pre-Freeze Adjustments - Dial Equipment Minutes (DEM) Factor

34. The Joint Board noted in the *Recommended Decision* that there has been an increase in intrastate usage patterns since 1995, as evidenced by the growth in local dial equipment minutes (DEM).⁸² The Joint Board suggested that one factor in this growth in local minutes may be the increase in the use of the local network to connect to the Internet, and the attendant long holding times associated with Internet usage.⁸³ The Joint Board also recognized, however, that other factors may be contributing to the growth in intrastate usage, including changes in the telecommunications environment that are resulting from the local competition provisions in the 1996 Act, or changes in technology.⁸⁴ The Joint Board recommended that the Commission further develop the record on this issue, and in particular, determine what, if any, impact the growth in local minutes has had on jurisdictional allocations and consumers.⁸⁵

35. The Joint Board recommended that, if the Commission finds in *Intercarrier Compensation for ISP-Bound Traffic Remand* proceeding that Internet traffic is interstate,⁸⁶ the Commission should freeze the local DEM factor for the duration of the freeze at some substantial portion of the current year level based on data from the twelve months preceding the implementation of the freeze.⁸⁷ Specifically, the Joint Board recommended that the Commission

⁸² *Recommended Decision*, 15 FCC Rcd at 13175-76, para. 28; see *Trends in Telephone Service*, Industry Analysis Division, Common Carrier Bureau, FCC, at Table 12.1 (March 2000) (indicating the following annual local DEM percentage increases: 8% (1996), 12% (1997), and 11% (1998)).

⁸³ *Id.* See also, e.g., NECA, NCTA, NRTA & OPASTCO *Recommended Decision* Reply 2-5. *Intercarrier Compensation for ISP-Bound Traffic Ruling*, 14 FCC Rcd at 3701-3703, 3710.

⁸⁴ *Recommended Decision*, 15 FCC Rcd at 13175-76, para. 28.

⁸⁵ *Recommended Decision*, 15 FCC Rcd at 13175-76, para. 28.

⁸⁶ *Recommended Decision*, 15 FCC Rcd at 13176, para. 29. Previously, on March 24, 2000, the United States Court of Appeals for the D.C. Circuit had vacated certain provisions of the *Intercarrier Compensation for ISP-Bound Traffic Ruling*, and remanded it to the Commission. The court did not dispute the Commission's conclusion that Internet traffic is interstate in nature, but rather questioned the Commission's explanation for why this jurisdictional analysis was relevant to the question of whether a call to an ISP was subject to the reciprocal compensation requirements of section 251(b)(5) of the Act. *Bell Atlantic v. FCC*, 206 F.3d 1 (D.C. Cir. 2000). On April 27, 2001, the Commission released its Order on Remand in the *Intercarrier Compensation for ISP-Bound Traffic* docket. This Order on Remand did not alter the Commission's conclusion that ISP-bound traffic is jurisdictionally interstate in nature. See *Implementation of the Local Competition Provisions of the Telecommunications Act of 1996, Intercarrier Compensation for ISP-Bound Traffic*, Order on Remand and Report and Order, CC Docket nos. 99-98, 99-68, FCC 01-131 (rel. April 27, 2001) (*Intercarrier Compensation for ISP-Bound Traffic Remand Order*).

⁸⁷ *Recommended Decision*, 15 FCC Rcd at 13176, para. 29. The Joint Board noted that several parties had recommended that a freeze of the Part 36 rules be accompanied by a classification of Internet traffic or Internet Service Provider (ISP)-bound traffic as interstate for separations purposes. See, e.g., Harris, Skrivan *NPRM* Comments at 6-7; TDS *NPRM* Comments at 9-13; BellSouth Dec. 6 *ex parte*; USTA Jan. 27 *ex parte*; see also TANE *Recommended Decision* Comments at 3-4. The Joint Board did not recommend that the Commission address the treatment of Internet traffic for separations purposes in the *Recommended Decision* due to an (continued....)

determine the precise percentage reduction of local DEM by looking to record evidence demonstrating the effect that Internet usage has had on jurisdictional allocations or consumers.⁸⁸ Given the inadequate record on this issue, the Joint Board stated that it could not recommend with precision what amount to reduce the DEM level by before application of the freeze. In order to facilitate the development of a specific record, however, the Joint Board suggested, as a default estimate, that the local DEM be frozen at 95% of the current year level based on data from the twelve months preceding the implementation of the freeze.⁸⁹ In other words, the Joint Board recommended that, at the outset of the freeze, the local DEM level for the base year be reduced by 5%, and that 5% would be shifted to interstate DEM, and the adjusted levels would be frozen.

36. Following the issuance of the *Recommended Decision*, the Common Carrier Bureau released a Public Notice that, among other things, sought comment on the Internet/DEM reduction issue as framed by the Joint Board.⁹⁰ The Bureau sought specific comment on "the impact of Internet traffic growth on jurisdictional allocations since 1995."⁹¹ The Bureau asked that commenters provide specific information on Internet usage minutes, including the percentage of local minutes attributable to Internet traffic, from ISPs both affiliated and non-affiliated with incumbent LECs.⁹² The Bureau also requested that, when estimates were used, the commenters provide explanations and underlying documentation supporting those estimates.⁹³

37. A number of parties oppose any reduction of the local DEM factor in conjunction with the interim freeze. BellSouth and Verizon argue that this course of action would undermine the stability that is one of the stated goals of the freeze, because, among other things, it would result in an immediate cost shift, and interject uncertainty into the Commission's position on the jurisdictional nature of Internet traffic.⁹⁴ Moreover, USTA, SBC, and several other commenters (Continued from previous page) _____ insufficient record on the issue. The Joint Board recommended that the Commission address this issue in the context of comprehensive separations reform. *See Recommended Decision* at 17, para. 29, n.68.

⁸⁸ *Recommended Decision*, 15 FCC Rcd at 13176, para. 29.

⁸⁹ *Recommended Decision*, 15 FCC Rcd at 13176, para. 29. We note that several commenters proposed a freeze for rate-of-return carriers that would be calculated based on data from an average of prior years, 1995-1997. *See, e.g.,* USTA Jan. 27 *ex parte*; Letter from Gina Harrison, NECA, to Magalie Roman Salas, FCC, dated February 4, 2000 (NECA Feb. 4 *ex parte*); Warinner, Gesinger *Recommended Decision* Reply at 2. USTA and NECA argued that basing the freeze on prior years was necessary in light of the impact the Internet has had on jurisdictional allocations beginning in 1996. *See Id.* We further note that we have committed in this Report and Order to address the impact of the Internet in the context of comprehensive reform, as suggested by several commenters. *See, e.g.,* USTA *Recommended Decision* Reply at 3.

⁹⁰ *See Jurisdictional Separations Reform and Referral to the Federal-State Joint Board*, CC Docket No. 80-286, Public Notice, DA No. 00-2433 (rel. October 30, 2000).

⁹¹ *Id.*

⁹² *Id.*

⁹³ *Id.*

⁹⁴ *See* BellSouth *Recommended Decision* Comments at 4; Verizon *Recommended Decision* Comments at 4-8.

recommend that the Commission move forward quickly to adopt a straightforward freeze, and address the Internet issue in the context of comprehensive separations reform.⁹⁵ Verizon contends that a local DEM reduction would contravene cost-revenue matching principles so long as the costs of ISP-bound traffic are recovered through state tariffs.⁹⁶ In addition, Pac-West and RCN note that it is impossible to accurately determine the appropriate level for a local DEM reduction.⁹⁷ AT&T and WorldCom oppose the local DEM reduction on the grounds that such actions would improperly allocate costs between the jurisdictions.⁹⁸ AT&T contends that Internet costs are properly allocated to the intrastate jurisdiction for separations purposes based on cost causation principles and also contends that the record in this proceeding is inadequate to support any local DEM reduction.⁹⁹ Alternatively, several commenters, including the California PUC and SBC, suggest that the Commission simply treat Internet traffic as interstate for separations purposes and avoid the need for any local DEM factor reduction.¹⁰⁰

38. On the other hand, NECA, many of the small rate-of-return carriers, Qwest, and several state commissions support the Joint Board's proposed 5 % DEM factor reduction (or a greater reduction ranging from 5 % to 35 %) to address the increased local usage that is alleged to be attributable to Internet traffic.¹⁰¹ Commenters' estimates on the percentage of intrastate traffic that represents Internet traffic range from 3.1% to 71.5%.¹⁰² The commenters who provided these estimates, however, did not provide much detail explaining how they arrived at those estimates, nor did they provide detailed studies or documentation. No party, furthermore,

⁹⁵ See, e.g., SBC *Recommended Decision* Reply at 2; USTA *Recommended Decision* Reply at 2.

⁹⁶ See Verizon *Recommended Decision* Reply at 1-3.

⁹⁷ See Pac-West/RCN *Recommended Decision* Reply at 2-5.

⁹⁸ See, e.g., AT&T *Recommended Decision* Reply at 9-11; California PUC *Recommended Decision* Reply at 10-13; Pac-West/RCN *Recommended Decision* Reply at 2-5; WorldCom *Recommended Decision* Comments at 1-6.

⁹⁹ See AT&T *Recommended Decision* Reply at 9-11.

¹⁰⁰ See, e.g., California PUC *Recommended Decision* Comments at 18-21, Reply at 10-13; SBC *Recommended Decision* Comments at 6; Warinner, Gesinger *Recommended Decision* Reply at 2-4.

¹⁰¹ See, e.g., NECA, NRTA, & OPASTCO *Recommended Decision* Reply at 7; Beacon *Recommended Decision* Reply at 4-7; JSI *Recommended Decision* Reply at 2-4; Qwest *Recommended Decision* Reply at 2-3; Warriner, Gesinger *Recommended Decision* Reply at 2-4; Wisconsin PSC *Recommended Decision* Reply at 7; Vermont PSB *Recommended Decision* Comments at 2-5.

¹⁰² See, e.g., Beacon *Recommended Decision* Reply at 4-7; JSI *Recommended Decision* Comments at 2-5, Reply at 2-4; NECA, NTCA, NRTA & OPASTCO *Recommended Decision* Comments at 2-5; SBC *Recommended Decision* Comments at 6, Exhibits A and B; TANE *Recommended Decision* Comments at 2-3; TCA *Recommended Decision* Comments at 2-3; Warinner, Gesinger *Recommended Decision* Reply at 2-4. JSI contends that a decision on a local DEM reduction cannot wait for the Commission's decision in *Intercarrier Compensation for ISP-Bound Traffic Remand* proceeding, because increased dial-up Internet traffic is already threatening rate-of-return carriers with cost shifts that could affect the affordability of basic local service rates in rural communities. See JSI *Recommended Decision* Comments at 2-5.

provided concrete evidence demonstrating rate increases or other actions directly attributable to increased Internet usage.

39. The Joint Board's concerns regarding increased Internet usage stem from the fact that costs for ISP-bound traffic, despite the jurisdictionally interstate nature of this traffic, are booked as intrastate for separations purposes. The Commission has directed carriers to treat the traffic-sensitive local switching costs that ISPs incur through their connections to LEC end-offices as intrastate for separations purposes, because these switching costs are recovered through intrastate business tariffs, and enhanced service providers such as ISPs are exempt from paying carrier access charges.¹⁰³ Revenue for ISP connections to LEC end offices, therefore, is collected on the intrastate side, and the Commission has previously concluded that costs for ISP-bound traffic should be booked as intrastate in order to avoid cost-revenue mismatches.

40. The Joint Board proposed a DEM reduction as a short-term way to shift some costs to the interstate jurisdiction, pending further review of the issue of how Internet-bound traffic should be treated for separations purposes. Even though the Commission recently reaffirmed in the *Intercarrier Compensation for ISP-Bound Traffic Remand* proceeding that Internet traffic is jurisdictionally interstate, we decline to reduce the local DEM factor as recommended by the Joint Board.¹⁰⁴ Based on the record developed from the *Recommended Decision*, we conclude that we lack reliable data upon which to set the amount of any local DEM factor reduction that may be warranted. We recognize that the record demonstrates some growth in local calling patterns, and we recognize that it may be reasonable to assume that some portion of this growth is attributable to increased Internet usage. Despite our efforts to focus the record on this issue, the parties have not presented reliable evidence that would allow us to quantify with any reasonable certainty the portion of local usage that can be attributed to Internet usage, and thus establish a reasonable amount of local DEM reduction that should be applied. No party has produced specific documentation of increased investment outlays, local rate increases, or requests for relief from carriers that have stemmed from sharp increases in local calling patterns due to increased Internet usage. We have no reliable data, therefore, upon which to set any reasonable local DEM reduction on an across-the-board, nationwide basis in order to compensate for any effects that Internet usage may have had on jurisdictional allocations or consumers. More importantly, we have no concrete evidence before us that the current situation has, in fact, had any detrimental impact upon consumers. In short, there is no demonstrable evidence in this record that freezing the local DEM factor at current levels would produce irrational results.

41. We note that our decision in the *Intercarrier Compensation for ISP-Bound Traffic Remand* proceeding has not affected our prior decision that local switching costs for ISP-bound traffic be treated as intrastate for separations purposes, because the ESP exemption remains in

¹⁰³ See, e.g., *General Communications Inc. v. Alaska Communications System Holdings, Inc., et al*, Memorandum Opinion and Order, FCC 01-32 (rel. Jan. 24, 2001) (2001 WL 58932) (*GCI Order*). This policy exempting enhanced service providers from the access charge regime is commonly referred to as the "ESP exemption."

¹⁰⁴ See *Intercarrier Compensation for ISP-Bound Traffic Remand Order* at paras. 52-65.

place and the local switching revenues for ISP-bound traffic continue to be collected on the intrastate side. As the Commission explained in the *GCI Order*, assigning ISP traffic-sensitive costs to the intrastate jurisdiction is a "reasonable measure" based on sound policy choices.¹⁰⁵ The assignment of the traffic-sensitive costs of ISP-bound traffic to the intrastate jurisdiction that follows from the ESP exemption derives from the application of the Commission's general separations principles to ISP-bound traffic in implementing the ESP exemption, and prevents a cost-revenue mismatch that the separations rules are designed to avoid.¹⁰⁶ Moreover, the Commission's decision to retain the ESP exemption has been affirmed as a lawful exercise of the Commission's discretion.¹⁰⁷ Our decision in the *Intercarrier Compensation for ISP-Bound Traffic Remand Order* has not altered the ESP exemption, nor the policy reasons for treating ISP-bound traffic as intrastate for separations purposes.

42. While we depart from the *Recommended Decision* and decline to require a local DEM reduction at the onset of the freeze, we do, however, commit to working with the Joint Board on a continuing basis to address the impact of the Internet and the growth in local minutes during the interim freeze. Furthermore, when the Commission and the Joint Board seek comment on the impact of the freeze after the freeze has been in effect for some time, we will seek specific comment on the status of the ISP-bound traffic issue, and the impact of the freeze on this situation.¹⁰⁸ If we are in the future presented with evidence that demonstrates with greater precision the impact of increased Internet usage on consumers or carriers, we can revisit this issue.

7. Data Collection and Reporting During Freeze

43. The Joint Board recommended that all carriers continue to report separations results under the Commission's current reporting rules.¹⁰⁹ Under the Joint Board's recommendation, ARMIS-reporting companies would continue to report separations results to the Commission, and companies participating in NECA pools would continue to report separations results to NECA. The Joint Board recommended, however, that the Commission no longer require price cap carriers to conduct certain underlying separations studies to assign costs to the Part 36 categories, and also recommended that neither price cap nor rate-of-return carriers should be required to calculate updated jurisdictional allocation factors.¹¹⁰

¹⁰⁵ *GCI Order* at para. 32.

¹⁰⁶ *GCI Order* at para. 32.

¹⁰⁷ *See SBC v. FCC*, 153 F.3d 523 (8th Cir. 1998).

¹⁰⁸ *See* section (III)(C)(5), *supra*.

¹⁰⁹ *Recommended Decision*, 15 FCC Rcd at 13177, para. 31. Separations data is reported annually by carriers in their ARMIS reports pursuant to Part 43 of the Commission's rules. *See* 47 C.F.R. § 43.

¹¹⁰ *Recommended Decision*, 15 FCC Rcd at 13177, para. 31.

44. Most commenters assert that carriers should not be required to file Part 36 separations reports and related cost studies during the freeze, noting that this easing of administrative burden is a primary benefit of the freeze.¹¹¹ Several commenters, however, support requiring carriers to continue annual separations reports and underlying studies to assign costs to the Part 32 categories and to compute the jurisdictional allocation factors.¹¹² These commenters contend that continuing the separations reporting and study requirements are necessary to effectively evaluate the freeze and accomplish meaningful separations reform.

45. We conclude, consistent with the Joint Board recommendation, that price cap carriers need not conduct separations studies to assign costs to the Part 36 categories and that neither price cap carriers nor rate of return carriers need to perform such studies to calculate allocation factors. We agree with the Joint Board that removal of this intermediary step will simplify the separations process and thereby ease administrative burdens on all ILECs.

46. We also agree with the Joint Board that carriers should continue to report separations results for the duration of the interim freeze. We conclude, however, that we can streamline our current separations reporting requirements, while receiving sufficient information to evaluate the freeze and consider further separations reform. We will freeze category relationships and allocation factors for price cap carriers based on the information provided by those carriers in the ARMIS 43-04 on April 1, 2001, which covers data for calendar year 2000. We will revise ARMIS 43-04 for subsequent years so that price cap carriers no longer need to report all of the information required in the current 43-04. Instead, under the streamlined ARMIS 43-04, price cap carriers will only report data necessary to evaluate further separations reform. Price cap carriers will file the new streamlined ARMIS 43-04 beginning April 1, 2002 and shall file that report on an annual basis for the duration of the freeze.¹¹³

47. We conclude that these modifications will simplify carrier reporting during the interim freeze, because carriers will no longer be required to compile and report all of the data currently required under the ARMIS 43-04. At the same time, the data provided in the streamlined ARMIS 43-04 will provide the Commission and Joint Board with the selected data necessary to evaluate further action in this area.

¹¹¹ See, e.g., *Qwest Recommended Decision* Comments at 6-8; *SBC Recommended Decision* Comments at 5; *USTA Recommended Decision* Comments at 8-9, Reply at 3.

¹¹² See, e.g., *California PUC Recommended Decision* Comments at 7, Reply at 7; *GSA Recommended Decision* Comments at 8-9, Reply at 6-9. (recommending elimination of annual separations studies for rate-of-return carriers only). See *GSA Recommended Decision* Reply at 9.

¹¹³ We direct the Bureau to seek comment on the content of the proposed streamlined ARMIS 43-04 report. This will provide interested parties, including the states, the opportunity to provide feedback on which specific accounts are needed to evaluate the freeze and consider further separations reform. We will adopt specific reporting requirements for ARMIS 43-04 in a subsequent order.

8. Adjustments During the Freeze

48. As explained above, the intent of the freeze is to stabilize and simplify the separations process. Accordingly, the Joint Board recommended that carriers should generally not be allowed to adjust the separations category relationships and allocation factors of price cap carriers or the allocation factors of rate-of-return carriers during the freeze.¹¹⁴ The Joint Board found that this prohibition of adjustments during the freeze is consistent with the stability sought through the freeze, pending more comprehensive reform of the separations process. The Joint Board noted, however, that carriers may request a waiver of the Part 36 freeze pursuant to the Commission's regulations, in order to make adjustments where special circumstances warrant such action.¹¹⁵

49. In recommending that adjustments to the separations category relationships and allocation factors should not be permitted during the freeze, the Joint Board recognized that, during the freeze, carriers may merge affiliated operations, or acquire from or sell exchanges to non-affiliated carriers. The Joint Board recommended that a carrier selling or otherwise transferring exchanges to another carrier's study area continue to employ its pre-transfer frozen factors and, if applicable, category relationships.¹¹⁶ The Joint Board recommended, however, that the acquiring carrier be required to recalculate its frozen factors and category relationships.¹¹⁷ The acquiring carrier would calculate new, composite frozen factors and category relationships based on a weighted average of both the seller's and purchaser's existing frozen factors and frozen category relationships. This weighted average would be based on the number of access lines currently being served by the acquiring carrier and the number of access lines in the transferred exchanges.¹¹⁸ The Joint Board believes that this approach will result in factors and

¹¹⁴ *Recommended Decision*, 15 FCC Rcd at 13177, para. 32.

¹¹⁵ *Recommended Decision*, 15 FCC Rcd at 13177, para. 32, citing 47 C.F.R. § 1.3

¹¹⁶ *Recommended Decision*, 15 FCC Rcd at 13177-78, para. 33. In certain instances, exchanges are transferred between study areas without a monetary transaction occurring. For example, affiliated carriers' may reconfigure study areas within a state. For ease of discussion, we may refer to transfers of exchanges as purchases or sales of exchanges.

¹¹⁷ *Recommended Decision*, 15 FCC Rcd at 13177-78, para. 33. The Joint Board recommended that, when acquiring exchanges, price cap carriers recalculate their frozen category relationships and jurisdictional allocation factors, and rate-of-return carriers recalculate their factors only. However, the merging and recalculating of category relationships would apply only to the investment categories in the COE (2210, 2220, 2230), IOT (2310), and C&WF (2410) accounts. Due to the company-specific nature of certain expenses, the Joint Board recommended that the acquiring carrier retain its own frozen category relationships for the categories within Account 6623, Customer Services Expense, and not merge them with those of the selling company.

¹¹⁸ *Recommended Decision*, 15 FCC Rcd at 13177-78, para. 33. To compose the traffic factors and category percentages of the purchasing company with those of the selling company, the purchasing company must (1) combine the (pre-purchase) access lines of the purchasing company (A) and the total access lines purchased from the selling company (B), and (2) multiply the factors and category percentages of the purchasing company by $A/(A+B)$ and those of the selling company by $B/(A+B)$ and sum the results.

category relationships that more accurately reflect the acquiring carrier's post-transfer study area.¹¹⁹

50. The Joint Board also recognized that, when exchanges are transferred, the transferred exchanges may not include all of the categories of investment found in the selling carrier's study area. Wishing to avoid the anomaly of creating categories of investment in the new study area that are not actually transferred to the purchaser,¹²⁰ the Joint Board recommended that the Commission require the acquiring carrier to remove all categories of investment from the selling carrier's category relationships where no such category investment exists within the sold exchange(s). The seller's remaining category relationships would then be increased proportionately to total 100 percent. Finally, the adjusted seller's category relationships would be composited with those of the acquiring carrier to determine the category relationships for the acquiring carrier's post-transfer study area.¹²¹

51. Several commenters support the recommendation that no adjustments during the freeze should be allowed and also support the proposed treatment of the sale or transfer of exchanges during the freeze.¹²² Several commenters support the recommendation, as a general matter, but propose that two exceptions be carved out: 1) when rate-of-return carriers incur new categories of investment during the freeze; and 2) when rate-of-return average schedule companies convert to become rate-of-return cost companies.¹²³ USTA, NECA, and several

¹¹⁹ *Recommended Decision*, 15 FCC Rcd at 13177-78, para. 33. For example, a small rural study area with high interstate factors could purchase exchanges from a large study area with low interstate factors. Without recalculation, the acquiring small company could apply its high interstate frozen factors to the acquired exchanges and, thus, unfairly burden the interstate jurisdiction.

¹²⁰ *Recommended Decision*, 15 FCC Rcd at 13178-79, para. 34, n.76. For example, if the purchasing company owns no host/remote investment and purchases a stand-alone central office from a large carrier that owns one or more host/remote switching complexes, the failure to remove the host/remote category relationships from the selling company's list of category investment would have the effect of creating COE Category 4.3 host/remote and CW&F Category 4 host/remote investment in the new study area of the purchasing company.

¹²¹ *Recommended Decision*, 15 FCC Rcd at 13178-79, para. 34.

¹²² *See, e.g., BellSouth Recommended Decision Comments at 3; GSA Recommended Decision Comments at 7; Qwest Recommended Decision Comments at 10; SBC Recommended Decision Comments at 5-6.*

¹²³ Of the more than 1200 ILECs participating in the tariff administered by NECA, approximately half receive settlements from NECA based on their actual costs. *See Universal Service Fund 1995 Submission of 1994 Study Results by the National Exchange Carrier Association, Inc. (Sept. 29, 1995).* These ILECs are termed "cost settlement LECs" or "cost companies" because the Part 36 rules require them to perform cost studies to separate certain types of costs. To avoid the expense of performing such studies, the remaining half of the ILECs participating in the NECA tariff receive interstate settlements based on "averaged" formulas. *See 47 C.F.R. § 69.605(c).* These small ILECs are commonly called "average schedule companies." NECA develops that schedule based on generalized industry data that reflect the costs of a typical small ILEC. These average schedule companies may convert to "cost companies" and receive compensation from NECA based on their company-specific costs. Once they make this election, however, they cannot later resume average schedule status. *See 47 C.F.R. § 69.605(c).*

commenters representing the interests of small carriers recommend that the Commission permit these two exceptions for adjustments to the allocation factors of rate-of-return carriers during the freeze.¹²⁴

52. We adopt the recommendations of the Joint Board regarding adjustments during the freeze, including the Joint Board's recommended treatment of the sale or transfer of exchanges. We agree with the Joint Board that this approach is an administratively simple one that is consistent with our goal of stabilizing the separations process by halting any jurisdictional cost shifts. In the event of any anomalies, we believe that the Commission's waiver process will provide a mechanism for relief when special circumstances warrant deviation from the freeze.

53. We do, however, recognize that the two exceptions proposed by the commenters present unique circumstances that may occur with some frequency. Accordingly, we adopt rules to address these two exceptions consistent with the recommendations of the commenters. Rate-of-return carriers who incur new categories of investment during the freeze shall calculate new factors for the investment and then freeze the new factors for the duration of the freeze. We agree with USTA that, without this exception, some rate-of-return carriers may be precluded from allocating their costs for recovery of the new investment from the proper jurisdictions.¹²⁵ We also recognize that carriers convert from average-schedule settlement status to cost-based settlement status every year. Rate-of-return carriers who convert from average schedule to cost company status during the freeze shall calculate new factors based on the twelve-month period immediately following the conversion and then freeze the new factors for the remainder of the freeze. We believe that providing this exception will expedite the process for those carriers by eliminating the need for waiver requests to calculate new factors following conversion.

9. Exogenous Cost Changes

54. Section 61.45 of the Commission's rules allows carriers subject to federal price cap regulation to adjust their price cap indices (PCIs) for "exogenous cost changes" to ensure that their PCIs accurately reflect all exogenous cost changes that may have taken place before the annual tariff filing.¹²⁶ The types of exogenous cost changes allowed are limited to those cost changes that the Commission shall permit or require by rule, rule waiver, or declaratory ruling.¹²⁷ Specifically, the exogenous cost changes allowed under the Commission's rules include those caused by "changes to the Separations manual."¹²⁸ As a general matter, therefore, changes to the

¹²⁴ See, e.g., *Beacon Recommended Decision* Reply at 7-8; *GVNW Recommended Decision* Comments at 4; *JSI Recommended Decision* Comments at 3, 6-8; *NECA, NRTA, NTCA & OPASTCO Recommended Decision* Comments at 8; *USTA Recommended Decision* Comments at 6,9; Reply at 2, n.7; *Warinner, Gesinger Recommended Decision* Reply at 2.

¹²⁵ See *USTA Recommended Decision* Comments at 6.

¹²⁶ See 47 C.F.R. § 61.45 *et seq.*

¹²⁷ 47 C.F.R. § 61.45(d).

¹²⁸ 47 C.F.R. § 61.45(d)(1)(iii).

Part 36 rules that result in a cost change to a price cap carrier are allowable exogenous cost changes.

55. We specifically find in this Report and Order that, based on the nature of the changes to Part 36 that we are adopting, price cap carriers shall not be allowed to claim exogenous cost adjustments under Part 61 of the Commission's rules as a result of the implementation of the freeze. Because the freeze will be based upon the most currently-available separations data at the time of its implementation, the freeze would not cause any cost changes for price cap carriers, and therefore we see no grounds upon which to allow for exogenous adjustments, including exogenous adjustments based on projections of where cost levels would be if not for the existence of the freeze. Furthermore, we note that because we are not adopting a local DEM adjustment, there will be no cost shifts between the jurisdictions as a result of any DEM adjustments, and therefore no grounds for exogenous cost adjustments under Part 61.¹²⁹

IV. PROCEDURAL MATTERS

A. Final Regulatory Flexibility Certification.

56. The Regulatory Flexibility Act of 1980, as amended (RFA),¹³⁰ requires that an RFA analysis be prepared for notice-and-comment rulemaking proceedings, unless the agency certifies that "the rule will not, if promulgated, have a significant economic impact on a substantial number of small entities."¹³¹ The RFA generally defines "small entity" as having the same meaning as the terms "small business," "small organization," and "small governmental jurisdiction."¹³² In addition, the term "small business" has the same meaning as the term "small business concern" under the Small Business Act.¹³³ A small business concern is one which: (1) is independently owned and operated; (2) is not dominant in its field of operation; and (3) satisfies any additional criteria established by the Small Business Administration (SBA).¹³⁴ Section

¹²⁹ See *Verizon Recommended Decision Comments* at 7 (arguing that, because of the potential for exogenous adjustments to interstate rates, moving Internet costs between the jurisdictions would cause the market disruption that the Joint Board seeks to avoid with the proposed freeze).

¹³⁰ The RFA, *see* § 5 U.S.C. S 601 *et seq.*, has been amended by the Contract With America Advancement Act of 1996, Pub. L. No. 104-121, 110 Stat. 847 (1996) (CWAAA). Title II of the CWAAA is the Small Business Regulatory Enforcement Fairness Act of 1996 (SBREFA).

¹³¹ 5 U.S.C. § 605(b).

¹³² 5 U.S.C. § 601(6).

¹³³ 5 U.S.C. § 601(3) (incorporating by reference the definition of "small business concern" in Small Business Act, 15 U.S.C. S § 632). Pursuant to 5 U.S.C. § 601(3), the statutory definition of a small business applies "unless an agency, after consultation with the Office of Advocacy of the Small Business Administration and after opportunity for public comment, establishes one or more definitions of such term which are appropriate to the activities of the agency and publishes such definition(s) in the Federal Register."

¹³⁴ Small Business Act, § 15 U.S.C. S 632.

121.201 of the Small Business Administration regulations defines a small telecommunications entity in SIC code 4813 (Telephone Companies Except Radio Telephone) as any entity with 1,500 or fewer employees at the holding company level.¹³⁵ As we described in the previous IRFA analysis in this proceeding, we recognize that proposals such as a freeze of the Part 36 separations process will affect all incumbent local exchange carriers providing interstate services, including some entities employing 1500 or fewer employees at the holding company level.¹³⁶

57. In the instant *Report and Order*, we amend Part 36 of our rules to adopt a variation of the freeze proposals set forth in the *NPRM*.¹³⁷ Specifically, the Commission adopts a five-year freeze of the Part 36 category relationships and allocation factors for price cap carriers and a freeze of the allocation factors only for rate-of-return carriers.¹³⁸ The objectives of the modified rules adopted in this *Report and Order* are to freeze the separations process in order to ease the administrative burden of regulatory compliance and to provide greater regulatory certainty for all local exchange carriers subject to the Commission's Part 36 rules, including small incumbent local exchange carriers (ILECs). For the reasons described below, we certify, pursuant to the RFA, that the rules adopted in this *Report and Order* will not have a significant economic impact on a substantial number of small entities. The interim freeze will eliminate the need for all ILECs, including ILECs with 1500 employees or fewer, to complete certain annual studies formerly required by the Commission's rules; if this action can be said to have any affect under the RFA, it is to reduce a regulatory compliance burden for small ILECs by eliminating the aforementioned separations studies and providing these carriers with greater regulatory certainty.

58. We note that we specifically considered the impact of the freeze on small ILECs (in general, rate-of-return carriers) in this *Report and Order* and provided them with the option to freeze their category relationships at the onset of the freeze.¹³⁹ We recognized that some small ILECs may be harmed if subject to a categories freeze, as it may reduce their ability to recover investment and receive sufficient universal service support, while other small ILECs may benefit from the added regulatory simplification and stability provided by a categories freeze.¹⁴⁰ Our action, therefore, either retains the status quo for small ILECs choosing to freeze their category relationships, or results in less regulatory burden for those opting for the categories freeze. Furthermore, we have committed to addressing the impact of Internet traffic on the separations results of all carriers, including small ILECs, in the context of the Commission's comprehensive separations reform, as we do not believe carriers are harmed by the current separations treatment

¹³⁵ 13 C.F.R. § 121.201.

¹³⁶ See *NPRM*, 12 FCC Rcd at 22169-22170. We note the Commission received no comments directly in response to the IRFA.

¹³⁷ See *supra*, para. 1; *NPRM*, 12 FCC Rcd at 22142-22145.

¹³⁸ See *supra*, para. 9.

¹³⁹ See *supra*, para. 21.

¹⁴⁰ See *id.*

of Internet traffic and will not be harmed as a result of the freeze.¹⁴¹

59. The Commission will send a copy of this *Report and Order*, including this final certification, in a report to Congress pursuant to the Congressional Review Act, *see* 5 U.S.C. § 801(a)(1)(A). In addition, the *Report and Order* and this certification will be sent to the Chief Counsel for Advocacy of the Small Business Administration, and will be published in the Federal Register. *See* 5 § U.S.C. § 605(b).

B. Paperwork Reduction Act

60. The action contained herein has been analyzed with respect to the Paperwork Reduction Act of 1995 and found to impose new or modified reporting and recordkeeping requirements or burdens on the public. Implementation of these new or modified reporting and recordkeeping requirements will be subject to approval by the Office of Management and Budget (OMB) as prescribed by the Act and will go into effect upon announcement in the Federal Register of OMB approval.

V. ORDERING CLAUSES

61. Accordingly, IT IS ORDERED that, pursuant to sections 1, 2, 4, 201-205, 215, 218, 220, 229, 254, and 410 of the Communications Act of 1934, as amended, 47 U.S.C. §§ 151, 152, 154, 201-205, 215, 218, 220, 229, 254 and 410 that the amendments to Part 36 of the Commission's rules, 47 C.F.R. Part 36, as described in this Report and Order and specified in Appendix C of this Report and Order ARE ADOPTED.

62. IT IS FURTHER ORDERED that Part 36 of the Commission's rules, 47 C.F.R. Part 36, IS AMENDED as set forth in Appendix C hereto, effective immediately upon publication in the Federal Register. Pursuant to 5 U.S.C. § 553(d)(3), we find that good cause exists to have the rules take effect immediately upon publication in the Federal Register. July 1, 2001 is the start of a new tariff year and, as such, it is essential that the amended rules take effect immediately upon publication in the Federal Register to enable carriers to keep their records in accordance with the Commission's rules. The interim freeze of Part 36 of the Commission's

¹⁴¹ *See supra*, para. 42

Rules, 47 C.F.R. § 36 *et seq.*, shall also be effective July 1, 2001. The revised collections of information contained within are contingent upon approval by the Office of Management and Budget.

FEDERAL COMMUNICATIONS COMMISSION

Magalie Roman Salas
Secretary

APPENDIX A**Parties Filing Comments and Reply Comments****Comments:**

1. AT&T Corp.
2. BellSouth Corporation / BellSouth Telecommunications, Inc.
3. CHR Solutions, Inc.
4. General Services Administration
5. GVNW Consulting, Inc.
6. John Staurulakis, Inc.
7. National Exchange Carrier Association, Inc., National Rural Telecom Association, National Telephone Cooperative Association, and Organization for the Promotion and Advancement of Small Telecommunications Companies
8. Pennsylvania Public Utilities Commission
9. Qwest Corporation
10. SBC Telecommunications, Inc.
11. Telecom Consulting Associates
12. Telephone Association of New England
13. United States Telecom Association
14. Verizon Telephone Companies
15. Vermont Public Service Board
16. WorldCom, Inc.

Reply Comments:

1. AT&T Corp.
2. BellSouth Corporation / BellSouth Telecommunications, Inc.
3. CHR Solutions, Inc.
4. General Services Administration
5. GVNW Consulting, Inc.
6. John Staurulakis, Inc.
7. National Exchange Carrier Association, Inc., National Telephone Cooperative Association, National Rural Telecom Association, and Organization for the Promotion and Advancement of Small Telecommunications Companies
8. Pennsylvania Public Utilities Commission
9. People of the State of California and the California Public Utilities Commission
10. Public Service Commission of Wisconsin
11. Qwest Corporation
12. SBC Communications, Inc.
13. Telecom Consulting Associates
14. Telephone Association of New England
15. United States Telephone Association
16. Verizon Telephone Companies
17. Vermont Public Service Board
18. Warinner, Gesinger & Associates, LLC
19. WorldCom, Inc.

Appendix B

Category Relationships and Jurisdictional Allocation Factors to Freeze

Categories/Subcategories to Freeze (by account)

Account 2210 - Central Office Switching

Category 2 – Tandem Switching Equipment

Category 3 – Local Switching Equipment

Account 2220 – Operator Systems

Category 1 – Operator Systems Equipment (by type of board)

- Separate toll boards
- Separate local manual boards
- Combined local manual and toll boards
- Combined toll and DSA boards
- Separate DSA and DSB boards
- Service observing boards
- Auxiliary service boards
- Traffic service positions

Account 2230 – Circuit Equipment

Category 4 – Circuit Equipment

Subcategory 4.1 – Exchange Circuit Equipment

4.11 – Wideband Exchange Line Circuit Equipment

4.12 – Exchange Trunk Circuit Equipment

4.13 – Exchange Line Circuit Equipment

- State private line and state WATS
- Interstate private line and interstate WATS
- Message telephone service

4.2 – Interexchange Circuit Equipment

4.21 – Interexchange circuit equipment furnished to another company for IS use

4.22 – Interexchange circuit equipment used for WDBD services including satellite and earth station equipment

4.23 – All other interexchange circuit equipment

- State private line and state WATS
- Interstate private line and interstate WATS
- Message telephone service

4.3 – Host/Remote Message Circuit Equipment

Account 2310 – Information Origination/Termination (IOT) Equipment

Category 1 – Other information origination / termination equipment

Category 2 – Customer premises equipment

Account 2410 – Cable & Wire Facilities

Category 1 – Exchange Line C&WF

- Subcategory 1.1 - State private line and state WATS
 1.2 - Interstate private line and interstate WATS
 1.3 - Subscriber lines jointly used for local exchange and exchange access

Category 2 – Wideband and Exchange Trunk C&WF

Category 3 – Interexchange C&WF

- Subcategory 3.1 - State private line and state WATS
 3.2 - Interstate private line and interstate WATS
 3.3 – Message telephone service

Category 4 – Host/Remote Message C&WF

Account 6620 – Services

Telephone Operator Expenses

Published Directory Listing

Category 1 – Local Business Office Expense

- End user service order processing
- End user payment and collection
- End user billing inquiry
- Interexchange carrier service order processing
- Interexchange carrier payment and collection
- Interexchange carrier billing inquiry
- Coin collection and administration

Category 2 – Revenue Accounting Expense

- Message processing expense
 - Toll ticket processing
 - Local message processing
- Other billing and collection expense
- Carrier access charge billing and collecting expense

Category 3 – All Other Customer Services Expense

Factors to Freeze (by Jurisdiction)

1. Subscriber Line Minutes of Use (SLU)
2. Weighted Standard Work Seconds (WSWS) – by type of board
3. Tandem switch minutes of use (Tdm MOU)
4. Dial Equipment Minutes (DEM) – measured (i.e. unweighted)
5. Exchange Trunk Minutes of Use (Exch Trk MOU)
6. Wideband Minutes of Use (WDBD MOU)

7. Conversation Minutes (CM)
8. Conversation Minute Kilometers (CMKm)
9. Host-Remote Minute of Use Kilometers (MOUKm)
10. Equal Access Minutes of Use (EA MOU)
11. End User service order processing – contact factor
12. End User payment & collection – revenue factor
13. End User billing inquiry – contact factor
14. IXC service order processing – contact factor
15. IXC payment & collection – revenue factor
16. IXC billing inquiry – contact factor
17. Coin collection & administration – revenue factor
18. Marketing - billed revenue factor
19. SP + RC messages
 20. TSPS Relative Processor Real Time (in seconds) [to allocate RTA investment in end office]

APPENDIX C**Final Rules**

Part 36 of Title 47 of the Code of Federal Regulations is amended as follows:

**PART 36 – JURISDICTIONAL SEPARATIONS PROCEDURES;
STANDARD PROCEDURES FOR SEPARATING TELECOMMUNICATIONS
PROPERTY COSTS, REVENUES, EXPENSES, TAXES AND RESERVES FOR
TELECOMMUNICATIONS COMPANIES**

Subpart A – General

1. Section 36.3 is added as follows:

§ 36.3 Freezing of jurisdictional separations category relationships and/or allocation factors

(a) Effective July 1, 2001, through June 30, 2006, all local exchange carriers subject to Part 36 rules shall apportion costs to the jurisdictions using their study area and/or exchange specific separations allocation factors calculated during the twelve month period ending December 31, 2000, for each of the categories/sub-categories as specified herein. Direct assignment of private line service costs between jurisdictions shall be updated annually. Other direct assignment of investment, expenses, revenues or taxes between jurisdictions shall be updated annually. Local exchange carriers that invest in telecommunications plant categories during the period July 1, 2001, through June 30, 2006, for which it had no separations allocation factors for the twelve month period ending December 31, 2000, shall apportion that investment among the jurisdictions in accordance with the separations procedures in effect as of December 31, 2000 for the duration of the freeze.

(b) Effective July 1, 2001, through June 30, 2006, local exchange carriers subject to price cap regulation, pursuant to § 61.41, shall assign costs from the Part 32 accounts to the separations categories/sub-categories, as specified herein, based on the percentage relationships of the categorized/sub-categorized costs to their associated Part 32 accounts for the twelve month period ending December 31, 2000. If a Part 32 account for separations purposes is categorized into more than one category, the percentage relationship among the categories shall be utilized as well. Local exchange carriers that invest in types of telecommunications plant during the period July 1, 2001, through June 30, 2006, for which it had no separations category investment for the twelve month period ending December 31, 2000, shall assign such investment to separations categories in accordance with the separations procedures in effect as of December 31, 2000.

(1) Local exchange carriers not subject to price cap regulation, pursuant to § 61.41, may elect to be subject to the provisions of § 36.3(b). Such election

must be made prior to July 1, 2001. Local exchange carriers electing to become subject to § 36.3(b) shall not be eligible to withdraw from such regulation for the duration of the freeze. Local exchange carriers participating in Association tariffs, pursuant to § 69.601 et seq., shall notify the Association prior to July 1, 2001, of such intent to be subject to the provisions of § 36.3(b). Local exchange carriers not participating in Association tariffs shall notify the Commission prior to July 1, 2001, of such intent to be subject to the provisions of § 36.3(b).

(c) Effective July 1, 2001, through June 30, 2006, any local exchange carrier that sells or otherwise transfers exchanges, or parts thereof, to another carrier's study area shall continue to utilize the factors and, if applicable, category relationships as specified in §§ 36.3(a) and (b).

(d) Effective July 1, 2001, through June 30, 2006, any local exchange carrier that buys or otherwise acquires exchanges or part thereof, shall calculate new, composite factors and, if applicable, category relationships based on a weighted average of both the seller's and purchaser's factors and category relationships calculated pursuant to § 36.3(a) and (b). This weighted average should be based on the number of access lines currently being served by the acquiring carrier and the number of access lines in the acquired exchanges.

(1) To compute the composite allocation factors and, if applicable, the composite category percentage relationships of the acquiring company, the acquiring carrier shall first sum its existing (pre-purchase) access lines (A) with the total access lines acquired from selling company (B). Then, multiply its factors and category relationship percentages by $(A/(A+B))$ and those of the selling company by $(B/(A+B))$ and sum the results.

(2) For carriers subject to a freeze of category relationships, the acquiring carrier should remove all categories of investment from the selling carrier's list of frozen category relationships where no such category investment exists within the sold exchange(s). The seller's remaining category relationships must then be increased proportionately to total 100 percent. Then, the adjusted seller's category relationships must be combined with those of the acquiring carrier as specified in § 36.3(d)(i) to determine the category relationships for the acquiring carrier's post-transfer study area.

(e) Any local exchange carrier study area converting from average schedule company status, as defined in Part 69.605(c), to cost company status during the period July 1, 2001, through June 30, 2006, shall, for the first twelve months subsequent to conversion categorize the telecommunications plant and expenses and develop separations allocation factors in accordance with the separations procedures in effect as of December 31, 2000. Effective July 1, 2001 through June 30, 2006, such companies shall utilize the separations allocation factors and account categorization subject to the requirements of §§ 36.3(a) and (b) based on the category relationships and allocation factors for the twelve months subsequent to the conversion to cost company status.

Subpart B – Telecommunications Property**Central Office Equipment**

2. Section 36.123 is amended as follows:

§ 36.123 Operator systems equipment - Category 1.

(a) . . .

(5) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to §61.41, shall assign the average balance of Account 2220, Operator Systems, to the categories/subcategories, as specified in § 36.123(a)(1) above, based on the relative percentage assignment of the average balance of Account 2220 to these categories/subcategories during the twelve month period ending December 31, 2000.

(6) Effective July 1, 2001 through June 30, 2006, all study areas shall apportion the costs assigned to the categories/subcategories, as specified in § 36.123(a)(1), among the jurisdictions using the relative use measurements for the twelve month period ending December 31, 2000 for each of the categories/subcategories specified in § 36.123 (b) through (e) below.

3. Section 36.124 is amended as follows:

§ 36.124 Tandem switching equipment - Category 2.

(a) . . .

(c) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to §61.41, shall assign the average balances of Accounts 2210, 2211, 2212 and 2215, to the Category 2, Tandem Switching Equipment based on the relative percentage assignment of the average balances of Account 2210, 2211, 2212 and 2215 to Category 2, Tandem Switching Equipment during the twelve month period ending December 31, 2000.

(d) Effective July1, 2001, through June 30, 2006, all study areas shall apportion costs in Category 2, Tandem Switching Equipment, among the jurisdictions using the relative number of study area minutes of use, as specified in § 36.124(b), for the twelve month period ending December 31, 2000. Direct assignment of any subcategory of Category 2 Tandem Switching Equipment between jurisdictions shall be updated annually.

4. Section 36.125 is amended as follows:

§ 36.125 Local switching equipment - Category 3.

(a) . . .

(h) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to §61.41, shall assign the average balances of Accounts 2210, 2211, 2212, and 2215 to Category 3, Local Switching Equipment, based on the relative percentage assignment of the average balances of Account 2210, 2211, 2212 and 2215 to Category 3, during the twelve month period ending December 31, 2000.

(i) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion costs in Category 3, Local Switching Equipment, among the jurisdictions using relative dial equipment minutes of use for the twelve month period ending December 31, 2000.

(j) If during the period from January 1, 1997, through June 30, 2006, the number of a study area's access lines increased or will increase such that, under § 36.125(f) the weighting factor would be reduced, that lower weighting factor shall be applied to the study area's 1996 unweighted interstate DEM factor to derive a new local switching support factor. The study area will restate its Category 3, Local Switching Equipment factor under § 36.125(f) and use that factor for the duration of the freeze period.

5. Section 36.126 is amended as follows:

§ 36.126 Circuit equipment - Category 4.

(a) . . .

(b) . . .

(1) . . .

(5) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to §61.41, shall assign the average balances of Accounts 2230 through 2232 to the categories/subcategories as specified in §§ 36.126(b)(1) through (b)(4) based on the relative percentage assignment of the average balances of Accounts 2230 through 2232 costs to these categories/subcategories during the twelve month period ending December 31, 2000.

(c) . . .

(1) . . .

(4) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion costs in the categories/subcategories, as specified in §§ 36.126(b)(1) through (b)(4), among the jurisdictions using the relative

use measurements or factors, as specified in §§ 36.126(c)(1) through (c)(3) for the twelve month period ending December 31, 2000. Direct assignment of any subcategory of Category 4.1 Exchange Circuit Equipment to the jurisdictions shall be updated annually.

(e) . . .

(1) . . .

(4) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion costs in the categories/subcategories specified in §§ 36.126(e)(1) through (e)(3) among the jurisdictions using relative use measurements or factors, as specified in §§ 36.126(e)(1) through (e)(3) for the twelve month period ending December 31, 2000. Direct assignment of any subcategory of Category 4.2 Interexchange Circuit Equipment to the jurisdictions shall be updated annually.

(f) . . .

(1) . . .

(2) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion costs in the subcategory specified in § 36.125(f)(1) among the jurisdictions using the allocation factor, as specified in § 36.125(f)(1)(i), for this subcategory for the twelve month period ending December 31, 2000. Direct assignment of any Category 4.3 Host/Remote Message Circuit Equipment to the jurisdictions shall be updated annually.

Information Origination/Termination Expenses

6. Section 36.141 is amended as follows:

§ 36.141 General.

(a) . . .

(c) Effective July 1, 2001, through June 30, 2006, local exchange carriers subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 2310 to the categories, as specified in § 36.141(b), based on the relative percentage assignment of the average balance of Account 2310 to these categories during the twelve month period ending December 31, 2000.

7. Section 36.142 is amended as follows:

§ 36.142 Categories and apportionment procedures.

(a) . . .

(c) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion costs in the categories, as specified in § 36.141(b), among the jurisdictions using the relative use measurements or factors, as specified in § 36.142(a), for the twelve month period ending December 31, 2000. Direct assignment of any category of Information Origination/Termination Equipment to the jurisdictions shall be updated annually.

Cable and Wire Facilities

8. Section 36.152 is amended as follows:

§ 36.152 Categories of Cable and Wire Facilities.

(a) . . .

(d) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 2410 to the categories/subcategories, as specified in §§36.152(a) through (c), based on the relative percentage assignment of the average balance of Account 2410 to these categories/subcategories during the twelve month period ending December 31, 2000.

9. Section 36.154 is amended as follows:

§ 36.154 Exchange Line Cable and Wire Facilities (C&WF) – Category 1 - apportionment.

(a) . . .

(g) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Subcategory 1.3 Exchange Line C&WF among the jurisdictions as specified in § 36.154(c). Direct assignment of subcategory Categories 1.1 and 1.2 Exchange Line C&WF to the jurisdictions shall be updated annually as specified in § 36.154(b).

10. Section 36.155 is amended as follows:

§ 36.155 Wideband and exchange trunk C&WF – Category 2 – apportionment procedures.

(a) . . .

(b) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Category 2 Wideband and exchange trunk C&WF among the jurisdictions using the

relative number of minutes of use, as specified in § 36.155(a), for the twelve-month period ending December 31, 2000. Direct assignment of any Category 2 equipment to the jurisdictions shall be updated annually.

11. Section 36.156 is amended as follows:

§ 36.156 Interexchange Cable and Wire Facilities (C&WF) – Category 3 – apportionment procedures.

(a) . . .

(c) Effective July 1, 2001, through June 30, 2006, all study areas shall directly assign Category 3 Interexchange Cable and Wire Facilities C&WF where feasible. All study areas shall apportion the non-directly assigned costs in Category 3 equipment to the jurisdictions using the relative use measurements, as specified in § 36.156 (b), during the twelve-month period ending December 31, 2000.

12. Section 36.157 is amended as follows:

§ 36.157 Host/Remote message Cable and Wire Facilities (C&WF) – Category 4 – apportionment procedures.

(a) . . .

(b) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Category 4 Host/Remote message Cable and Wire Facilities C&WF among the jurisdictions using the relative number of study area minutes-of-use kilometers applicable to such facilities, as specified in § 36.157(a)(1), for the twelve month period ending December 31, 2000. Direct assignment of any Category 4 equipment to the jurisdictions shall be updated annually.

Equal Access Equipment

13. Section 36.191 is amended as follows:

§ 36.191 Equal access Equipment.

(a) . . .

(d) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Equal Access Equipment, as specified in § 36.191(a), among the jurisdictions using the relative state and interstate equal access traffic, as specified in § 36.191(c), for the twelve month period ending December 31, 2000.

Subpart C – Operating Revenues and Certain Income Accounts**Operating Revenues**

14. Section 36.212 is amended as follows:

§ 36.212 Basic local services revenue – Account 5000.

(a) . . .

(c) . . .

(1) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Wideband Message Service and TWX revenues among the jurisdictions using the relative number of TWX minutes of use for the twelve-month period ending December 31, 2000.

15. Section 36.214 is amended as follows:

§ 36.214 Long distance message revenue – Account 5100.

(a) . . .

(1) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Wideband Message Service and TWX revenues among the jurisdictions using the relative number of TWX minutes of use for the twelve-month period ending December 31, 2000.

Subpart D – Operating Expenses and Taxes**Customer Operations Expenses**

16. Section 36.372 is amended as follows:

§ 36.372 Marketing – Account 6610.

(a) . . .

(1) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion expenses in this account among the jurisdictions using the analysis, as specified in § 36.372(a), during the twelve-month period ending December 31, 2000.

17. Section 36.374 is amended as follows:

§ 36.374 Telephone Operator Expenses.

(a) . . .

(b) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the Telephone operator expense classification based on the relative percentage assignment of the average balance of Account 6620 to this classification during the twelve month period ending December 31, 2000.

(c) Expenses in this classification are apportioned among the operations on the basis of the relative number of weighted standard work seconds as determined by analysis and study for a representative period.

(d) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Telephone operator expenses among the jurisdictions using the relative number of weighted standard work seconds, as specified in § 36.374(c), during the twelve-month period ending December 31, 2000.

18. Section 36.375 is amended as follows:

§ 36.375 Published directory listing.

(a) . . .

(b) . . .

(1) . . .

(5) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the classifications, as specified in §§ 36.375(b)(1)-(4), based on the relative percentage assignment of the average balance of Account 6620 to these classifications during the twelve month period ending December 31, 2000.

(6) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Published directory listing expenses using the underlying relative use measurements, as specified in §§ 36.375(b)(1)-(4), during the twelve-month period ending December 31, 2000. Direct assignment of any Publishing directory listing expense to the jurisdictions shall be updated annually.

19. Section 36.377 is amended as follows:

§ 36.377 Category 1 – Local business office expense.

(a) . . .

Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the subcategories, as specified in § 36.377(a), based on the relative percentage assignment of the average balance of Account 6620 to these categories/subcategories during the twelve month period ending December 31, 2000.

(1) . . .

(i) . . .

(ix) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the categories/subcategories, as specified in § 36.377(a)(1)(i) through (viii), based on the relative percentage assignment of the average balance of Account 6620 to these categories/subcategories during the twelve month period ending December 31, 2000.

(a) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion TWX service order processing expense, as specified in § 36.377(a)(1)(viii) among the jurisdictions using relative billed TWX revenues for the twelve-month period ending December 31, 2000. All other subcategories of End-user service order processing expense, as specified in §§ 36.377(a)(1)(i)-(vii), shall be directly assigned.

(2) . . .

(i) . . .

(vii) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620- Services to the subcategories, as specified in § 36.377(a)(2)(i) through (vi), based on the relative percentage assignment of the average balance of Account 6620 to these categories/subcategories during the twelve month period ending December 31, 2000.

(a) Effective July 1, 2001, through June 30, 2006, all study areas

shall apportion TWX payment and collection expense, as specified in § 36.377(2)(vi) among the jurisdictions using relative billed TWX revenues for the twelve-month period ending December 31, 2000. All other subcategories of End User payment and collection expense, as specified in §§ 36.377(a)(2)(i)-(vi), shall be directly assigned.

(3) . . .

(i) . . .

(vii) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the subcategories, as specified in §§ 36.377(a)(3)(i) through (vi), based on the relative percentage assignment of the average balance of Account 6620 to these subcategories during the twelve month period ending December 31, 2000.

(a) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion TWX billing inquiry expense, as specified in § 36.377(a)(3)(v) among the jurisdictions using relative billed TWX revenues for the twelve-month period ending December 31, 2000. All other subcategories of End user billing inquiry expense, as specified in §§ 36.377(a)(3)(i)-(iv),(vi) shall be directly assigned.

(4) . . .

(i) . . .

(vii) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the subcategories, as specified in § 36.377(a)(4)(i) through (vi), based on the relative percentage assignment of the average balance of Account 6620 to these subcategories during the twelve month period ending December 31, 2000.

(a) All subcategories of Interexchange carrier service order processing expense, as specified in §§ 36.377(a)(4)(i)-(vi), shall be directly assigned.

(5) . . .

(i) . . .

(vii) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to §61.41, shall assign the average

balance of Account 6620-Services to the subcategories, as specified in § 36.377(a)(5)(i) through (vi), based on the relative percentage assignment of the average balance of Account 6620 to these subcategories during the twelve month period ending December 31, 2000.

(a) All subcategories of Interexchange carrier payment expense, as specified in §§ 36.377(a)(5)(i)-(vi), shall be directly assigned.

(6) . . .

(i) . . .

(vii) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the subcategories, as specified in § 36.377(a)(6)(i) through (vi), based on the relative percentage assignment of the average balance of Account 6620 to these subcategories during the twelve month period ending December 31, 2000.

(a) All subcategories of Interexchange carrier billing inquiry expense, as specified in §§ 36.377(a)(6)(i)-(vi), shall be directly assigned.

(7) . . .

(i) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the subcategories, as specified in § 36.377(a)(7), based on the relative percentage assignment of the average balance of Account 6620 to these subcategories during the twelve month period ending December 31, 2000.

(ii) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Coin collection and administration expense among the jurisdictions using the relative state and interstate revenues deposited in the public and semi-public telephones, as specified in §§ 36.377(a)(7), for the twelve month period ending December 31, 2000. Direct assignment of any Coin collection and administration expense among the jurisdictions shall be updated annually.

20. Section 36.378 is amended as follows:

§ 36.378 Category 2 – Customer services (revenue accounting).

(a) . . .

(b) . . .

(i) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the classifications, as specified in § 36.378(b), based on the relative percentage assignment of the average balance of Account 6620 to those classifications during the twelve month period ending December 31, 2000.

21. Section 36.379 is amended as follows:

§ 36.379 Message processing expense.

(a) . . .

(b) . . .

(i) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the subcategories, as specified in § 36.379(b), based on the relative percentage assignment of the average balance of Account 6620 to those subcategories during the twelve month period ending December 31, 2000.

(ii) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Toll Ticketing Processing Expense among the jurisdictions using the relative number of toll messages for the twelve-month period ending December 31, 2000. Local Message Process Expense is assigned to the state jurisdiction.

22. Section 36.380 is amended as follows:

§ 36.380 Other billing and collecting expense.

(a) . . .

(d) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the Other billing and collecting expense classification based on the relative percentage assignment of the average balance of Account 6620 to those subcategory during the twelve month period ending December 31, 2000.

(e) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Other billing and collecting expense among the jurisdictions using the allocation factor utilized, pursuant to §§ 36.380(b) or (c), for the twelve month period ending December

31, 2000.

23. Section 36.381 is amended as follows:

§ 36.381 Carrier access charge billing and collecting expense.

(a) . . .

(c) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to the Carrier access charge billing and collecting expense classification based on the relative percentage assignment of the average balance of Account 6620 to that classification during the twelve month period ending December 31, 2000.

(d) Effective July 1, 2001, through June 30, 2006, all study areas shall apportion Carrier access charge billing and collecting expense among the jurisdictions using the allocation factor, pursuant to § 36.381(b), for the twelve-month period ending December 31, 2000.

24. Section 36.382 is amended as follows:

§ 36.382 Category 3 - All other customer services expense.

(a) Effective July 1, 2001, through June 30, 2006, study areas subject to price cap regulation, pursuant to § 61.41, shall assign the average balance of Account 6620-Services to this category based on the relative percentage assignment of the average balance of Account 6620 to this category during the twelve month period ending December 31, 2000.

(b) Category 3 is apportioned on the basis of Categories 1 and 2.